Assessment of the Current State of VAT Implementation in SADC Member States

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Assessment of the Current State of VAT Implementation in SADC Member States: Towards VAT Revenue Enhancement, Co-ordination and Co-operation

I. Introduction to study

The Southern African Development Community (SADC) is a regional development Community that evolved out of the Southern African Development Co-ordination Conference (SADCC), which was established in 1980. It has fourteen Member States namely Angola, Botswana Democratic Republic of the Congo (DRC), Lesotho, Madagascar (from Aug 2005), Malawi, Mauritius, Mozambique, Namibia, South Africa, Swaziland, United Republic of Tanzania (Tanzania), Zambia and Zimbabwe.

This study undertakes an assessment (including an economic assessment of the current state of Value Added Tax (VAT) implementation among SADC Member States. It should be noted, however, that as the study was concluded in early 2005 and Madagascar only joined SADC in August 2005, Madagascar is not included in the study. Consequently, reference below to SADC having 13 Member States reflects the period prior to Madagascar joining SADC.

Many of the SADC Member States are additionally members of other regional groupings such as East African Community (EAC) and Common Market for Eastern and Southern Africa (COMESA). A particularly important grouping as far as this study is concerned is the Southern African Customs Union (SACU) that has as its member countries South Africa, Botswana, Lesotho, Namibia and Swaziland. It can be seen that all the SACU member countries are also SADC Member States. Furthermore, within SACU there is a grouping excluding South Africa (Botswana, Lesotho, Namibia and Swaziland) commonly referred to as the BLNS countries.

The SADC tax coordination agenda is being taken forward as part of wider SADC financial integration that is being operationalised by a series of Memoranda of Understanding (MOU's) that will be subsumed into a binding SADC Protocol on Finance and Investment (FIP) in 2006.

The SADC tax coordination agenda is reflected in the SADC MOU on "Cooperation in Taxation and Related Matters" (SADC Tax MOU) that was signed in August 2002. This emphasizes the need for SADC Member States to take explicit steps to harmonize their tax systems and Article 6(1)(2)(9) and (10) of the MOU emphasizes the importance of effective coordination, harmonization and cooperation in the formulation of policy and administration of VAT or sales tax. It says, "Member States will take such steps as are necessary to harmonize their VAT regimes and will:

(a) set minimum standard rates;

(b) harmonize, over time, the application of zero-rating and VAT exemption of goods and services; and
(c) establish a SADC forum for collectively dealing with VAT matters."

The view, that indirect tax systems on consumption should be harmonized, is consistent with a recent recommendation of the World Trade Organization (WTO) for SACU member countries. The WTO review stated:

"*Differences in internal taxation between SACU members increase transaction costs for traders, encourage smuggling and tax evasion, and distort trade flows. In practice, when goods are exported from one SACU country to another, the shipper applies for VAT/sales tax refunds from the exporting country, and then pays the relevant tax to the importing country. Filing paperwork with two different countries unnecessarily increases the costs of conducting international trade. In the absence of harmonization, border controls have to be maintained within the SACU area. Harmonizing the taxation system would be more trade-friendly, and would foster economic integration within the region, and between the SACU area and the rest of the world."*[1]

At the same time, however, SADC Member States are at different stages of development, face different fiscal pressures, and have different capacities to raise tax revenues to meet their public sector revenue demands. The implications of these factors on the pace at which harmonization of indirect tax systems can be achieved need to be included in the assessment of how fast co-ordination of VAT systems can be achieved.

Since the VAT started to be implemented internationally in the 1960s, its use has grown rapidly around the world. By April 2001, some 123 countries had implemented VAT systems.[2] Since Malawi first introduced a VAT system to its Surtax in 1989 and South Africa introduced VAT in 1991, 10 of the 13 SADC Member States have introduced VAT with 3 of these countries since 2001. Zimbabwe is the most recent in January 2004. Three countries have alternative domestic indirect tax systems, Angola, DRC and Swaziland. There is significant VAT experience within the region, but many countries are still in the early stages of implementation.

Given that the VAT is fairly demanding in terms of high standards of accounting and book keeping, it places a significant compliance burden on the private sector taxpayer. Any new tax system also demands the development of adequate tax administration capacity to make it efficient and effective. Hence, the adequacy of the current tax administrations in SADC Member States to administer VAT will have an impact on:

(a) whether or not the remaining countries will be able to introduce VAT systems in the medium term, and

[1] World Trade Organization, Trade Policy Review: Southern African Customs Union, Report by the Secretariat, WT/TPR/S/114, 24 March 2003, p32

[2] Liam Ebrill, Michael Keen, Jean-Paul Bodin and Victoria Summers, *The Modern VAT*, IMF , Washington DC (2001), Table 1.3.

(b) whether or not the revenue performance and administrative capacities of the countries that already have VAT systems will permit harmonization of the VAT systems in the medium term as well.

It will also be important to identify the tax structure differences that need to be reduced and administrative capacity changes and strengthening that need to be introduced to allow this harmonization of VAT systems in SADC. To accelerate the effective reform of VAT structures and to strengthen VAT administration will require a degree of co-operation across member countries. It will be important to identify the potential areas of administration reform as these will form the agenda for future SADC co-operation in the area of taxation.

A VAT imposed on consumption (sometimes referred to as a "destination principle" VAT) taxes imports, but zero rates exports. Its successful implementation clearly depends on the effective administration by customs of taxes on international trade. Customs administration controls trade at the border, collects taxes on imports, and verifies exports.

Co-operation and co-ordination between SADC Member States with regard to trade is being operationalised through the SADC Trade Protocol. This was concluded in 1995 but only entered into force in 2000 with the accession of South Africa. The SADC Trade Protocol envisages a SADC Free Trade Area (FTA) by 2008 but this is being implemented incrementally by the Member States and it is planned that it will be complete by 2012. SADC has the goal of a customs union by 2010 and a common market by 2015 that (as outlined in the SADC Regional indicative Strategic Development Plan (RISDP)). Notably, free trade has long existed within SACU where customs and excise duties are collected in a pooled fashion and border controls between member countries have been relaxed, but not fully removed. Border controls within the SADC FTA will remain as rules of origin will be applied to determine goods coming from within SADC, but the nature of border controls that will remain as SADC develops into a customs union and subsequently a common market have not yet been determined. The nature of these border controls will dramatically impact the nature of the VAT structure and the nature and extent of coordination that can be successfully implemented in the SADC region in the long-term. As the European Union (EU) is finding out, their VAT systems are becoming increasingly difficult to enforce now that national boundaries have, in principle, disappeared for economic purposes under their "common market."

From an economic perspective it is important that VAT systems in SADC are neutral to investment and trade decisions across the region, while still being effective revenue raising instruments for Member States. The movement towards freer trade within the region will need to be accompanied by a sequence of changes to Member States' national VAT laws as well as international or regional treaties to sustain VAT systems in a SADC FTA or common market.

In light of the introductory observations, the remainder of this study is structured as follows:

- Chapter II gives a short summary of the diversity of the states of the economies in the SADC region.
- Chapter III reviews
    - first, the current status and revenue importance of the domestic indirect tax systems and provides a more systematic introduction to the tax structure issues that arise with the implementation of a VAT in the context of developing countries and,
    - second, situations where international fiscal boundaries may be weakened in the context of establishing a common market.
- Chapter IV gives a brief description of the economic and fiscal status of each country and some detail on the role and status of its domestic indirect taxes and especially its VAT or sales tax systems.
- Chapter V focuses on the revenue demands faced by SADC Member States, especially those arising out implementation of the SADC and SACU agreements regarding trade and macroeconomic convergence, and the potential for VAT to solve these revenue problems.
- Chapter VI analyses the tax capacity relating to structural features of the economies (sector, trade, poverty, educational status, etc) of the SADC Member States in some detail to understand the potential of the VAT and other taxes in general to solve their revenue problems. It goes on to further analyze the effective size of the tax bases available in each country (or VAT efficiencies) and the implication of these for revenue yields from changes in the standard VAT rates.
- Chapter VII reviews the roles of exemptions (including the minimum turnover rate for registration for the VAT), zero rating and refund rules, in reducing the effective VAT base and in creating distortions in trade and investment decisions across SADC Member States.
- Chapter VIII analyses the issues arising in the operation of a VAT in a multi-jurisdictional region where the customs controls are weakened or removed and evaluates the various options available to SADC members to sustain the VAT system. It identifies the various options available depending upon the strength of border controls maintained and also analyzes a range of different approaches to revenue sharing that would take into account he differences in trade balances between the member countries and their different VAT collection efficiencies
- Chapter IX presents the results of a survey of SADC Member States of their tax administration structures and capacities to administer a VAT, sales or turnover tax. It analyzes the status of tax administration across member countries and identifies strengths and weakness across these countries as well as suggesting directions for reforms and potential areas of cooperation between member countries.
- Chapter X draws the conclusions and recommendations arising from the study including the prospects for converging on a standard VAT structure.

The body of the report is supported by a series of appendices as follows:

- Appendix A gives some details of the new SACU revenue sharing arrangements.

- Appendix B tabulates the VAT, sales or turnover tax exemption and zero rating structures of the SADC Member States.
- Appendix C analyses the importance of customs to VAT collection effectiveness.
- Appendix D expands in some detail on the different approaches to dealing with the application of a VAT within a common market.
- Appendix E develops some different ways of sharing VAT revenues between member countries that deal with equity and efficiency problems that arise in the case of pooled revenue collections.
- Appendix F provides the template questionnaire answered by the revenue authorities in the Member States.
- Appendix G lists officials of SADC member states interviewed in the course of the study.

II. Economic background on SADC Countries

Members of SADC number fourteen countries as at August 2005. These include all the countries in the southern region of Africa reaching from South Africa up to the DRC in the west, Zambia in the center, and Tanzania on the east of Africa plus the islands of Mauritius and Madagascar.[3] Given this study predates Madagascar joining SADC, it only refers to the other 13 countries. See Table 2.1. Before focusing on the policy and structural issues of the VAT and the directly relevant structures of the various economies, it is useful to introduce the diversity of the SADC Member States. First in terms of broad classifications, Table 2.1 shows that there are five middle-income countries, namely, all the members of the Southern African Customs Union (SACU), except for Lesotho, plus Mauritius. All the other eight members are low-income countries six of which are classified as "Least Developed Countries (LDC)" by the United Nations (UN), five of these six have been designated as Heavily Indebted Poor Countries (HIPC) and of these five, four are classified as severely indebted.

Table 2.1: Income and Indebtedness Classification of SADC Member States

	Income class	UN Least Developed Country (LDC)	Heavily Indebted Poor Country (HIPC)	Indebted
Angola	Low	*	*	Severely
Botswana	Upper middle			Less
DRC	Low	*	*	Severely
Lesotho	Low	*		Less
Malawi	Low	*	*	Severely
Mauritius	Upper middle			Less
Mozambique	Low	*	*	Less
Namibia	Lower middle			Less
South Africa	Lower middle			Less
Swaziland	Lower middle			Less
Tanzania	Low	*	*	Moderately
Zambia	Low	*	*	Severely
Zimbabwe	Low			Moderately

World Bank, *World Development Indicators*, 2003

The economies of SADC Member States are relatively small. Table 2.2 shows that all the member countries except for South Africa had Gross Domestic Products (GDPs) below ten billion United States Dollars in 2001. The size of the South African economy dominates the SADC region. The GDP of South Africa, which stood at US$ 113 billion in 2001, is nearly twice as large as all the other members combined GDP. With a population of 44 million, South Africa is the second largest in the SADC region compared to the 52 million in the DRC, however, the GDP per capita in South Africa ranks third behind those of the two upper-middle income countries, namely, Mauritius and Botswana. The SADC region also contains some countries with very low per capita incomes, including Tanzania ($271), Mozambique ($197), Malawi

[3] The Seychelles was a member of SADC but withdrew in 2003.

($166), and the DRC ($99). In later Chapters, these low-income countries will also be seen to have large agricultural sectors (along with large informal and non-monetary sectors) plus low educational attainment in their adult populations. These factors will be shown to put severe limits on the capacity of these countries to raise domestic taxes. Differences in their import to GDP shares and in their external financial relations that result in different level of gross national disposable income (GNDI) compared to their gross domestic production will become evident. The consumption possibilities that form the VAT consumption tax base are ultimately supported by the GNDI, which may be supported by financial and transfer inflows.

All these countries, however, have strong common interests in regional trade and investment.

Table 2.2: GDP, Population and Per capita GDP, SADC Member States, 2001

	GDP	Population	GDP per capita
	US$, millions	*Millions*	*US$*
Angola	9,471	13.5	701
Botswana	5,196	1.7	3,066
DRC	5,187	52.4	99
Lesotho	797	2.1	386
Malawi	1,749	10.5	166
Mauritius	4,500	1.2	3,751
Mozambique	3,569	18.1	197
Namibia	3,100	1.8	1,730
South Africa	113,270	44.4	2,550
Swaziland	1,255	1.1	1,175
Tanzania	9,341	34.4	271
Zambia	3,639	10.3	354
Zimbabwe	9,057	12.8	706

World Development Indicators 2003

III. Overview of VAT/ sales tax status and issues

3.1. General tax issues

As mentioned in Chapter I, the VAT has been a remarkable innovation in international taxation that has spread to the tax systems of the majority of the countries in the world since the 1960s, especially the type of VAT structured as a credit-method tax using the destination principle (taxing imports, but not exports). It has attractive features, including:

(i) as a tax on domestic consumption, the potential to remove taxes from investment and exports, and
(ii) effective collections because of -
   a. the collection of taxes on all non-exempt imports (in contrast to the normal sales tax),
   b. the "self-enforcing" nature of the tax in that registered taxpayers require VAT paid invoices from their suppliers in order to gain credit for the input taxes to keep their output prices competitive, and
   c. the effective paper trail it provides to tax administrators of the input and output activities of a registered taxpayer to assist with effective audit within and between taxpayers.
(iii) Moreover, in low-income countries, which tend to rely heavily on indirect taxes (including import duties) as opposed to direct taxes in middle and high-income countries, the VAT (along with other domestic indirect taxes such as the excise duties) has to serve the double duty of enhancing government revenues as well as replacing import duties as countries undertake trade liberalization measures.

The VAT, as a broad-based tax on consumption, is often expected to solve a range of fiscal problems. Its primary role is often seen as a substitute for trade taxes (principally customs duties) in the process of trade liberalization. Its secondary, but ultimate long-term role is to be a major efficient source of government revenues.

Therefore generally, the VAT is seen as a major source of economic efficiency gains in revenue collections as a substitute for trade taxes on final consumption goods. A number of such situations are identified below. Where trade taxes (customs duties) are being removed, however, these efficiency gains may not be achieved by VAT substitution, and the VAT may well struggle to replace the forgone revenues. For example, if trade taxes are being removed from intermediate and capital goods (rather than final consumption goods), as is often the case in the early years of trade liberalization, then the VAT puts an *added tax burden* on final goods consumption rather than substituting for import duties on theses goods. Similarly, a range of trade tax changes arising out of the new SACU and SADC agreements are explored later to ascertain the extent of their revenue consequences, whether or not these will impact on final consumption or other goods, and whether or not VAT will be able to cover any revenue short-falls. At the same time, in addition to the trade liberalization planned between SADC Members States, some SADC countries are undertaking more traditional switches from trade to consumption taxes. In addition, for a number of

SADC Member States, the degree of freedom of using the VAT to replace trade taxes may also be constrained by the fact that the existing VAT rates are already high. These country-specific situations are identified below.

Aside from substituting for trade taxes, SADC Member States are and will be faced by increasing revenue demands. Already countries may have large debts and be running sizable budget deficits. They may also be financing a large share of expenditures with foreign aid. The size and scope of some these added revenue demands are identified across SADC countries and the scope of VAT to solve them is considered.

In situations where the import duties are *not* being lowered on *final consumption goods*, attempts to raise revenues with higher VAT rates will raise domestic prices. The price responsiveness of the effective VAT tax base will therefore have a significant impact on the effectiveness of the VAT to raise revenues. The price responsiveness of the base will depend upon the structure of the economy that may constrain the base on which the VAT can be effectively applied. In addition, the degree to which the base is further lost through exemptions and zero-rating is further explored. These issues become a major focus of later Chapters.

As a tax on consumption, the VAT should not affect investment decisions between countries. If the VAT is not ideally structured, however, such as through exemptions that may either favor imports, or zero-rating that is structured to favor domestic producers, or delays in VAT refund payments that effectively tax exporters and investors, the economically neutral role of the VAT can be become distorted. The extent and sources of such trade and investment biases is identified in the exemption, zero-rating and refund structures of the VAT systems in the SADC Member States in Chapter VII.

3.2. VAT within a trade preference area

The credit-method VAT has had an effective performance internationally as a domestic tax on consumption when imposed *nationally* using the destination principle. The fundamental reason for this is that as a *national* tax it utilizes the existing customs controls at the border to collect taxes on imports and verify exports. Within such national structures, individual countries can impose and vary VAT rates independently without causing major economic distortions between countries, e.g., the consumers in the countries with the higher VAT rates bear the higher tax burden. Problems arise, however, when countries apply the VAT at sub-national levels in federal systems such Brazil, Canada, or India. These problems arise in such systems because of the lack of economic border controls between the states of a federation. Solutions require the federal government to play a strong supervisory role, and possibly a compensatory role between states to ensure effective collection and appropriate revenue allocation. Similar, and possibly more acute problems arise within preferential trade areas, such as a common market, if the internal border controls on trade within the region are relaxed or removed. The European Union (EU) has faced problems that it still has to resolve completely in the enforcement of the European VAT as it has relaxed the internal economic borders in recent years. As discussed later, the higher the share of final taxes collected on imports by a

country, the more challenging the problems created by relaxed border controls. Typically, lower income countries collect a significant share of final VAT from imports, and therefore, these taxes can be put at risk with relaxed border controls. In addition, problems of VAT export frauds are expected to increase with relaxed border controls, and pressures for cross-border shopping in response to tax rate differential between countries also increase. As discussed in more detail below, some of these problems are already arising within SACU as evidenced by South Africa and Lesotho establishing a bilateral treaty to assist with the better enforcement of the VAT in transactions between these countries.

With the agreement by SADC Member States to move towards a common market, to gain the full benefit of freer trade within the region, pressures will arise to relax internal border controls on trade between Member States. This provides SADC with a major agenda to consider carefully the options to sustain and to coordinate the VAT systems across member countries. This topic is analyzed in detail in subsequent Chapters.

3.3. Role and importance of indirect taxes and sales taxes/VAT in SADC Member States

As already noted above, as of January 2004 with the introduction of the VAT in Zimbabwe, ten of the then thirteen member countries in SADC had introduced broad-based credit method VATs. See Tables 3.1 and 3.2. The first of these tables gives the importance of the domestic sales tax, VAT or similar taxes over 1997-2001 as measured by the ratio of tax revenues to GDP and the share that these revenues form of total revenues (tax plus non-tax revenues, but excluding grants):

- Relative to GDP, four countries exceeded 5 percent (Malawi, South Africa, Zambia and Zimbabwe) and three were below 3 percent (Angola, Botswana and DRC).
- Relative to total revenues, the countries with the highest shares were Mozambique, Tanzania, Malawi and Zambia in the range of 29 to 35 percent, while countries with the lowest shares (below 10 per cent) were Botswana, Angola, DRC and Lesotho.

With the exception of Lesotho and DRC, among the low-income countries, VAT or sales taxes were important shares of total revenues. Among the middle-income countries, while as a share of GDP, VAT and sales taxes can be relatively high, as a share of total revenues they tended to be lower as other sources, especially the income tax, increase in importance. Among the SACU members (excluding South Africa), the SACU customs and excise collections are important alternative source of tax revenues.

Table 3.1: Relative importance of broad-based domestic sales tax or VAT in SADC Member States over 1997-2001

Average percentage over 1997-2001

Country	Tax over GDP	Tax over Total revenue	Type of tax
Angola	2.1	5.5	Manufacturers "Selective Sales" Tax (non-oil)
Botswana	1.8	4.1	Retail Sales Tax (selective)
DRC	0.4	6.8	Producers Turnover
Lesotho (%GDP)	4.5	8.6	Retail Sales Tax
Lesotho (%GNDI[a])	3.1	8.6	
Malawi	5.3	29.8	Manufacturers level VAT
Mauritius	4.0	18.4	VAT
Mozambique	4.2	34.4	Sales Tax/VAT(1999)
Namibia	4.8	14.9	Retail Sales Tax
South Africa	5.8	22.2	VAT
Swaziland	3.7	12.8	Retail Sales Tax
Tanzania	3.2	30.2	Sales Tax/VAT(1999)
Zambia	5.5	29.1	VAT
Zimbabwe	5.7	20.2	Retail Sales Tax

a. GNDI = Gross National Disposable Income. In the case of Lesotho, GNDI exceeds GDP by 44% in 1997-2001. See table 6.7. For most countries GNDI differs from GDP by less than 10%

Table 3.2 gives the importance of VAT or sales tax revenues in the most recent fiscal year for which data was available along with the standard tax rate charged in that year. As of 2001, Botswana, Lesotho and Zimbabwe had not introduced their VATs, and Malawi had not expanded out its VAT from the manufacturers to retail level. Except for the Zimbabwe VAT, which commenced only in 2004, some of these revenue impacts are captured in Table 3.2. Compared to the revenue performance shown in Table 3.1, the average tax-over-GDP ratio increased by 0.8 percentage points and the share of total revenues increased by 3.4 percentage points. The largest increases in the tax-to-GDP ratio came in Botswana, Mauritius, Mozambique, Namibia, and Zimbabwe.

The standard tax rates of VAT have moved into a fairly narrow range of 10 to 20 percent and average 15.2 percent in Table 3.2. It is notable that the highest rates are among the low-income countries with Malawi (20%), Tanzania (20%), Zambia (17.5%), and Mozambique (17%), while the two highest income countries have low rates with Botswana (10%) and Mauritius (12%). These four low-income countries all rely on the VAT for a high share of the total revenues.

Table 3.2: Most recent figure on relative importance of broad-based domestic sales tax or VAT in SADC Member States

Country	Standard tax rate	Fiscal Year (Year end)	Tax over GDP	Tax over Total revenue	Type of tax
	%		%	%	
Angola	10	2002	3.0	7.7	Manufacturers excise or "selective sales" tax (non-oil)
Botswana	10	2003	3.7	8.8	VAT
DRC	13	2001	0.3	6.9	Producers Turnover
Lesotho (%GDP)	14	2003	4.4	11.3	VAT (July 2002)
Lesotho (%GNDI)		2003	2.9		
Malawi	20	2003	6.2	33.0	Retail VAT (Sept 2002)
Mauritius	12	2002	5.7	28.2	VAT
Mozambique	17	2002	4.9	38.0	VAT
Namibia	15	2003	6.7	21.2	VAT
South Africa	14	2003	6.3	25.6	VAT
Swaziland	14	2002	3.6	14.7	Retail Sales Tax
Tanzania	20	2002	4.1	33.8	VAT
Zambia	17.5	2002	5.0	28.8	VAT
Zimbabwe	15	2002	7.4	24.1	Retail Sales Tax
Zimbabwe	15	2004	9.9	30.3	VAT

Finally, Table 3.3 gives the dates of introduction of VAT in the ten countries with VAT systems. It also gives the standard VAT rate at the time of introduction and as it was then in 2004. Generally, standard rates are continuing to converge on a rate around 15% with the exception of Zimbabwe, which has raised its standard rate from 15% to 17.5%, but only as a temporary revenue measure during September-December 2005:

- Lesotho raised its rate from 10% to 14%,
- Mauritius raised its rate from 8% to 12% and is now charging 15%,
- Namibia raised its rate from 11% to 15%.
- South Africa lowered its rate at VAT introduction from 13% to 10%, but subsequently raised it to 14%.
- Malawi has lowered its rate from 30% in 1989 to 20%, and recently in 2005 to 17.5%, and
- Zambia has come down to 17.5%

Both the DRC and Swaziland have VATs under preparation. DRC proposes introduction in 2005.

Table 3.3: Date of VAT becoming effective

Country	Date VAT effective	Date of Fiscal year end	Standard VAT rate at introduction	Standard VAT rate in 2004
Botswana	July 2002	March 31	10	10
Lesotho	July 2003	March 31	14	14
Malawi	November 1989 at manufacturers level	March 31	30	
	September 2002 at retail level			20
Mauritius	September 1998	June 30	12	15
Mozambique	June 1999	December 31	17	17
Namibia	November 2000	March 31	15	15
South Africa	September 1991	March 31	10	14
Tanzania	July 1998	June 30	20	20
Zambia	July 1995	December 31	20	17.5
Zimbabwe	January 2004	December 31	15	15

IV. Country descriptions of status of turnover, sales tax and VAT in revenue systems of SADC Member States

This Chapter provides a brief description of the broad-based domestic goods and services taxes, whether structured as a turnover, sales tax or VAT, in each of the SADC Member States. The structure and role of these taxes is described and any changes or developments in these domestic goods and services taxes, such as the introduction of a VAT are covered here. The descriptions provide a context for these taxes in terms of the overall fiscal and macroeconomic structure of each economy, particularly any developments in the economy that may have had a major impact on the development of the tax system over recent years. This will provide a comprehensive picture (or snap shot) of each country that may be particularly useful as most of the rest of this study tends to present the tax system of the Member State in a comparative fashion focusing on specific issues or features of VAT.

Angola

During the 1990s, about 47 percent of economic output came from mining, mainly reflecting the large oil sector. Oil production has been the "fuel" of economic growth over much of Angola's post independence history. The rest of the economy, more vulnerable to the disruptions of a persistent civil war and the consequences of interventionist and hyperinflationary macroeconomic policy, has been less fortunate and has remained depressed[4]. For a low-income country, Angola has had high government expenditures (averaging around 50% of GDP) and overall deficits over the 1990s. See Table 4.1. Inflationary deficit financing resulted in inflation averaging over 100% in the 1990s peaking at 4,146% in 1996. The inflation rate has declined in recent years from 329% in 1999, but was still 106% in 2002. Government expenditures have moderated somewhat, reducing deficits, but remains relatively high.

Angola derives over 98 percent of its central government revenue from taxation. The structure of Angola's tax receipts is also heavily dependant on oil revenues with over 75 percent of taxes coming from that sector. Oil production is taxed though a corporation tax, a transaction tax and a production tax. Direct taxes in the oil sector were close to 40 percent of total direct taxation in 1992, flowing from corporation taxes, and increased to 81 percent by 1999. The tax regime shifted away from indirect to direct taxation as transaction taxes were phased out in favor of corporation taxes. Production taxes remained close to the average of 24 percent of total oil taxes during the 1990s.

Following a comprehensive reform of non-oil taxes in 1992, Angola succeeded in collecting an average of 32 percent of its total revenues as indirect taxes in that decade, but over two-thirds of these revenues were derived from oil taxes. Trade taxes formed less than 5% of total revenue or less than 2% of GDP. The trade regime is highly protected and does not utilize the harmonized tariff code system useful for data analysis comparisons[5].

Non- oil indirect taxes on goods and services are mainly excise taxes (*imposto de consume)*, which have only formed a small share of Angola total revenues (including grants): 2.4 % in 1992-96 and 5.4% in 1997-2001. Excise taxes have been charged on manufacturers' or producers' sales and imports. They have been structured as a series of selective excise taxes, but in 1999, the laws and regulations relating to these excises were consolidated into a single Excise Tax decree, but special excise decrees were retained for alcohol and oil products.[6,7] The excises can be viewed as a "selective sales tax" at the manufacturers level, but Angola does not have a general tax on consumption such as general sales tax or VAT on goods and services with a separate set of excises on luxury goods. The excise decree covers all types of goods, but special added decrees apply to alcohol and oil products. Most recent data for 2002 show these non-oil selective sales or excise taxes collecting 3% of GDP or 7.7% of total revenues.

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[4] IMF, Angola Recent Economic Developments, Nov 17, 1997
[5] The IMF has estimated the effective rate of protection on consumer goods to be between 135 and 174 percent compared with the nominal rate of 24 percent. See above reference.
[6] Decree 41/99, December 10, 1999
[7] Tax Information for Angola, SADC member country Tax Law Database, August 2003

The Excise Tax or "selective consumption or sales tax" has a standard rate of 10 percent with a reduced or subsidized rate of 2 percent in place for basic foods, soap, and specified equipment for medical services and agriculture, and rates ranging from 15 to 50 percent for luxury goods. By June 2003 the subsidized rates were raised to 5% and the goods subject to higher rates or surcharges were set at 20% and 30%. Industrial raw materials and intermediates are subject to tax, but the use of these in industrial processes by exempt businesses is also exempted. Without any general input tax exemption or credit system, significant tax cascading occurs. Selected services such as hotels, telecommunications, water and electricity are subject to tax. Exemptions are constrained mainly to exports, unprocessed primary sector products, micro business enterprises and equipment for use in the domestic livestock industry.[8]

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Table 4.1 Angola, Budget aggregates and Revenue Composition, Averages for 1992-96 and 1997-2001

	Percentages	
	1992-96	**1997-2001**
Total expenditures (including net lending) as share of GDP	51.0	46.0
Total Revenue + Grants as share of GDP	35.9	43.3
Overall surplus (deficit) as share of GDP	-15.16	-2.74
Revenue sources as shares of (Total revenue + Grants)		
Grants	0.7	5.6
Non-tax revenue	1.4	0.9
Tax Revenue	97.9	93.5
Indirect taxes (oil + non-oil)	31.3	32.5
Indirect taxes (non-oil)	8.2	9.7
Selective sales/excise tax (non-oil)	2.4	5.4

[8] Angola: Selected Issues and Statistical Appendix, IMF Country Report 3/292, September 2003

Botswana

Revenue from taxation averages around 50 percent of total revenue (around 24 percent of GDP) according to the GFS classification that classifies mineral property income revenue as non-tax receipts[9]. The Botswana economy has grown steadily at around 6 percent over the past 10 years, with notable acceleration in the past five years. This has resulted in generating the second highest per capita GDP at US$3,066 in 2001 among the SADC Member States (see Table 2.2). Despite the significance of the mining sector in overall economic growth, other service sectors including trade, transport, utilities and financial services have recorded growth rates higher than the overall average reflecting the increasing diversification of the economy. This strong economic performance has allowed Botswana to run an overall fiscal surplus and repay foreign debt over the past five years despite government expenditure in the higher range for SADC countries (see Table 5.5.). Inflation has remained under control declining from low teens in to single digits over the 1990s to 2001[10].

Extensive changes were made to the tax system from 1995. The marginal personal income tax rate was reduced to 25 percent in 1997 equalizing the top rate with company taxes. New mining tax arrangements made provisions for a Variable Rate Income Tax to replace individual and more discretionary agreements. The mining tax rate now varies annually between 25 and 55 percent. This resulted in increased mining revenue being reported as mining taxes from 1997/98 onwards. The sector accounts for 35 percent of GDP, mainly reflecting the significant role played by diamond production. Mineral revenue has declined from 31 percent of GDP (55 percent of total revenues) to average around 22 percent of GDP (still over 50 percent of revenues (50.6%)) over the past decade. See Table 4.2.

Approximately 20% of tax revenue is derived from indirect taxation. Indirect taxes mainly comprise trade, excise and motor vehicle taxes and a VAT that was introduced in July, 2002 to replace the general sales tax (that had been in place since 1982.) Customs and excise duties (5.5 percent of GDP or 12.1 percent of total revenue for Botswana) are pooled with other SACU members and redistributed according to the agreed SACU formula.

Prior to 2002, a single stage, selective sales tax was levied at 10%. Subsequent legislation in 1996 broadened the base of the tax to include selected services, with a small corresponding impact on revenues. Sales tax revenues had steadily increased in importance as a share of total revenue, from less than 1 percent in the 1980s to 4.8 percent by 2001/02. As a share of GDP, revenue from the sales tax grew strongly in the early 1990s breaking above one percent of GDP in 1993 (possibly reflecting improved administration as a separate sales tax department was established that year) and steadily increased to average 1.8 percent for the period 1997 – 2002.

The VAT (introduced in 2002[11]) retained a uniform rate of 10 percent on imported and locally produced goods and services[12]. The compulsory registration threshold is

[9] IMF classifies all mineral revenue as corporation taxes, raising tax revenues to over 78 percent of total revenue (average 1992 – 2002) Source. IMF Selected Issues and Statistical Appendix 1998 and 2002.
[10] World Development Indicators 2002
[11] Republic of Botswana, Value Added Tax, 2000, Act No 1 of 2001, Government Printer, Gaborone.

BWP 250,000 or about USD 40,000 when introduced[13]. The VAT structure includes exemptions for health, education and welfare services, immovable property, betting and gaming, non-profit organizations and financial services[14]. Exports, select oil products and select international services are zero-rated[15]. Maize meal and sorghum are zero rated to protect the poor, while petrol, diesel and paraffin are zero rated as they are subject to excise duties. Although it is too early to assess the impact of the VAT, 2003 collections of 3.7 percent of GDP (8.8 percent of total revenues) showed a distinct upward shift from the 2002 sales tax revenue levels.

Table 4.2. Botswana, Budget aggregates and Revenue Composition, Averages for 1992/93-96/97 and 1997/98-2001/02

(Fiscal Year beginning April 1)

	Percentages	
	1992/93-96/97	**1997/98-2001/02**
Total expenditures (including net lending) as share of GDP	38.6	51.2
Total Revenue + Grants as share of GDP	44.5	43.6
Overall surplus (deficit) as share of GDP	6.0	2.4
Revenue sources as shares of (Total revenue + Grants)		
Grants	1.8	1.0
Non-tax revenue[1]	24.9	17.4
Tax Revenue[1]	73.2	81.5
Indirect taxes (SACU)	16.0	15.2
General sales tax	3.3	4.3
Mineral Revenue	46.4	53.6
Non-mineral income taxes	7.2	8.0

1. Using IMF classification of all mineral revenues as taxation.

[12] IBFD, March 2003
[13] IBFD, March 2003
[14] Cnossen, 2003
[15] IBFD, March 2003

Democratic Republic of Congo

The Democratic Republic of Congo (DRC) is a mainly agrarian economy, deriving over half of its economic output from agriculture. Nonetheless, export earnings are largely dependant on the mining sector – diamond sales generate over 64% of export earnings.[16] The country has only recently begun to emerge from a protracted civil conflict culminating in the outbreak of war in 1998, and security remains unstable. Government institutions and structure are being reformulated and strengthened as part of the post-conflict reconstruction, but continue to be hampered by poor infrastructure and bureaucracy. The impact of years of economic disruption is evident in the trend of government revenue earnings. From an average of 12 percent of GDP in the late 1980s total revenue and grants declined by close to 50 percent during the 1990s. Expenditure remained around 20 percent of GDP for the decade from 1985 to 1995, but fell sharply in the late 1990s, depressed by central bank losses and slow disbursement of foreign financed investment spending after the IMF withdrew in 1991.[17] Even so, government spending was financed mainly through grants and foreign financing, which covered over 72 percent of outlays. The overall deficit averaged 6.4% for the period 1997 – 2001, the second lowest amongst SADC countries in that period. See Table 4.3. Hyperinflation in the early 1990s saw price increases in the five digits range in 1994. Inflation remains a threat to macroeconomic programming at over 300% in 2001.

The DRC collects an average of close to 85% of its revenue from taxation, declining only in 1999 to 69%, after the outbreak of war. Sources of tax receipts in recent years were almost evenly split between international trade, goods and services, and income, contributing an average of 1.45, 1.4 and 1.24 percent of GDP respectively during 1997 – 2001.

Taxes on goods and services comprise mainly a turnover tax and selective excise taxes.[18,19] During 1997–2001, turnover tax revenue was collected evenly from domestic goods and services and imported goods, with each sub-category contributing 0.3% of GDP for a total equivalent to 10.7% of total revenues. The tax is levied on services, the gross amount of sales of manufactured goods, three quarters of the amount on construction works invoice, the CIF value of imports and presumptively on small enterprises. The current structure does not protect against cascading since input taxes are not deducted. Six rates of turnover taxes are applicable depending on the transaction, ranging from 3% for manufactures that have a social or cultural consumptive purpose, raw materials, packaging materials and spare parts; 6% for transport operations within the DRC (15% for international flights), to the standard of 13 percent on the sale of goods and 18% for construction works. The highest rate, 30%, applies to non-resident service provision. The 3% tax rate also extends to exports of minerals, coffee, timber and unrefined oil, and is withheld at source by banks handling payment. Exemptions include sales subject to excise duty, locally made arts and craft, and certain service supplies.

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[16] www.iss.com/drc
[17] IMF April 2004
[18] IMF, Democratic Republic of DRC Selected Issues and Statistical Appendix IMF Country Report No. 01/123 July 2001
[19] Tax structure description from International Bureau of Fiscal Documentation, ATS, Supplement No 119, June 2001 (unless otherwise specified)

Major reforms to the tariff and tax system are currently being supported by the World Bank and the IMF in preparation for the planned introduction of a VAT in 2005. Measures relevant to the turnover tax were legally adopted in March 2003 and are expected to be implemented by 2004. These include allowance for the deduction of turnover taxes on inputs, the elimination of the tax on exports, consolidation of the six rates to two, 3% and 13%, to be applied to investment and agriculture inputs and all other products respectively, including products currently subject to the excise tax[20].

Excise duties are applied through eight rates between 3% and 40% on selected consumer products, both locally produced and imported. A 15% rate also applies to petroleum products. Revenue from selective excises averaged 0.8% of GDP or 14.5% of total revenues during 1997 – 2001. Expected reforms to the tax structure in 2004 include an increase in excises on petroleum products with the elimination of quasi-fiscal levies and the elimination of excises on sugar, cement and matches.

Table 4.3 DRC, Budget Aggregates and Revenue Composition, Averages for 1992-96 and 1997-2001[1]

	Percentages	
	1992-96	**1997-2001**
Total expenditures (including net lending) as share of GDP	18.1	12.2
Total Revenue and Grants as share of GDP	5.4	6.4
Overall surplus (deficit) as share of GDP	-15.9	-5.8
Revenue sources as shares of (Total revenue + Grants)		
Grants		…
Non-tax revenue	14.2	17.2
Tax Revenue	85.8	82.8
Indirect taxes	77.0	56.6
Turnover Tax	7.0	10.7
Selective excise tax	15.5	14.5

1. *1992-1996 averages from GFS, 1997-2001 from IMF*
2. *Shares/GDP from ADB*

[20] IMF April 2004

Lesotho

Lesotho is a small, low-income country, geographically landlocked within South Africa and heavily dependant on the South African economy for its economic well being.[21] Fifty eight percent of the population lives below the poverty line with most of the employed working as subsistence farmers or as migrant miners to South Africa. Remittances from these migrant farmers are a significant source of income, but have declined from 50 percent of GDP to around 20 percent in recent years due to the declining supply of South Africa mining jobs.[22] Growth in the services and agricultural sectors has also slowed in the late 1990s. On the upside, performance and investments in textile and garment manufacturing has been positively affected by preferential arrangements first with the EU and presently with the US AGOA program, making the sector the largest employer[23]. This growth area has also spilled over to construction, which averages around 11 percent of GDP.

From an overall deficit of 16.9 percent of GDP in 1987/88, the overall fiscal balance improved steadily to a surplus of 5.4 percent of GDP in 1993/94, but then worsened again thereafter becoming a deficit again in 1998/99 through 2000/01. Government spending, including net lending, is the highest of SADC countries at an average of 50 percent of GDP during FYs 1997–2001.[24] Expenditures have moderated in recent years. Government revenues increased from around 36 percent in the late 1980s, to over 48 percent of GDP by 1996/97, also the highest among SACU countries. Revenue has since declined to average around 41 percent since 2000/01. During 1997–2001, Lesotho derived a 75 percent share of its revenues and grants, or 34 percent of GDP, from taxation. Non-tax revenues averaged 19 percent of total revenues during the same period, including water royalties and compensatory payments from South Africa for seignorage. Foreign grants made up around 5.8 percent of the total revenues and grants or 2.6 percent of GDP. Table 4.4 summarizes Lesotho government financial operations.

Tax revenues are drawn mainly from international trade through custom duties and excise, 21 percent of GDP, followed by income, 7.5 percent of GDP, then sales taxes on goods and services, 3.8 percent of GDP. Lesotho tax policy hopes to shift revenue dependency away from customs duties, which are pooled as SACU receipts with an expected declining share for the country under new SACU arrangements (see Table 5.3). Taxes on goods and services currently include trade licenses and petrol levy in addition to a value added tax, which has replaced the sales tax.

Lesotho implemented a value added tax in July 2003[25] to be administered within the newly constituted Lesotho Revenue Authority.[26,27] Prior to this, a 10 percent single-staged sales tax with provision for input tax deductions and credits as under a value

[21] The Lesotho loti is pegged to the South African rand within the Common Monetary Area (CMA).
[22] IMF Lesotho: Selected Issues and Statistical Appendix, April 2004.
[23] IMF Selected Issues, 2004
[24] Government spending is over 10 percentage points lower when measured as a share of gross national disposable income (GNDI) rather than GDP. See Table 4.4.
[25] Value Added Tax Act 2001 and Value Added Tax (Amendment) Act 2003
[26] The originally planned date for implementation was April, 2002. This date was changed to the following fiscal year as the government tried to fulfill self imposed preconditions to ensure administrative readiness for the tax. www.lesotho.gov.ls/article/2002
[27] Lesotho Revenue Authority Act 2001

added structure was in place since 1996 (replacing a prior sales tax regime in place since 1982), but still using a system of exemption certificates for registered vendors to ensure that the tax was paid only at the retail level.[28] Nonetheless, exemption of input taxes was selective, exemption certificates were often abused and the sales tax system was considered administratively demanding.[29] The sales tax was structured to prepare the way for the value added tax. The value added tax introduced is harmonized with South Africa at a standard rate of 14 percent and levied on every taxable supply and import of goods and services. Three other rates apply as they had under the sales tax structure: 15 percent on liquor, 5 percent on utilities, exports and basic items are zero-rated. Revenue collections for 2002/03, which include about 8 months of VAT at 14% compared to sales tax at 10%, so far show no increase in tax yield from the 4.4% of GDP and 2.9% of GDNI in the prior year.

Exemptions under the sales tax structure also continue to apply but exemptions are further extended under the VAT. Exemptions include the supply of public, postal, transportation, water, medical, financial and education services, cultural activities, charitable activities by a permanent establishment, the supply of un-developed land and the supply of immovable property where the tenant is a manufacturer and uses the property to this end, leased or rented accommodations, and supply for low income housing development.[30] Government purchases, exempted under the sales tax structure are not exempted from the value added tax. The taxable threshold for mandatory registration has been increased from LSL250,000 applicable under the sales tax regime to LSL500,000.

Table 4.4 Lesotho, Budget Aggregates and Revenue Composition, Averages for 1992/93-96/97 and 1997/98-2001/02

(Fiscal Year beginning April 1)

	Percentages	
	1992/93-96/97	**1997/98-2001/02**
Total expenditures (including net lending) as share of GDP	46.7	49.3
Total Revenue + Grants as share of GDP	51.0	45.5
Overall surplus (deficit) as share of GDP	4.2	-3.7
Revenue sources as shares of (Total revenue + Grants)		
Grants	9.8	5.8
Non-tax revenue	14.0	19.0
Tax Revenue	76.2	75.2
Indirect Taxes	61.8	58.7
General sales tax	9.7	8.3
GDNI/GDP	186.7	144.1

[28] IBFD, December 2002
[29] www.lesotho.gov.ls/article/2002.
[30] IMF Selected Issues, 2004, Summary of the Tax System as at July 2003.

Malawi

Overall economic growth in the Malawian economy is heavily driven by the agricultural sector, principally smallholder farmers who contribute 70 percent of the output[31]. Since 1994, agriculture has averaged around 34 percent, with agriculture becoming an increasingly more important source of national income, earning over 90 percent of export revenues and employing over 90 percent of the population[32]. Smallholders are the main source of growth in the sector. Agriculture is also the most volatile sector due to the vulnerability to recurring droughts[33]. Economic activity in the remaining sectors has been muted over the past decade. The manufacturing sector is recording a declining share of GDP, with growth just above 1 percent for 1994–2000. Services received a strong boost from financial and professional activities in the mid-1990s, but this performance was not sustained through the early 2000s. Overall, real growth has been slow and highly unstable. Over 1990-2001 real growth averaged 3.5 percent (about 1.1 per above the population growth rate), but the standard deviation in the annual growth rates over this period was 7.4 percent, more than double the average growth rate.

Consumption in the private sector has been an increasing share of GDP, from around 70 percent in the late 1980s to over 84 percent on average in the last half of the 1990s. Total consumption has risen from around 90 percent to 100 percent of GDP.

Government revenues remained around 17 percent of GDP in the 1990s despite surges and slumps in GDP over the period, possibly reflecting the fact that most of the activity in the dominant agriculture sector remains outside the tax net. Government expenditures also remained stable at around 30 percent over the same period. Malawi received around 6 percent of GDP in grants (close to one-quarter of total revenue and grants) over 1997-2001, while it also receives around 5.2 percent of GDP in net foreign financing (see Table 5.5).

Malawi obtains around 90 percent of its revenue (excluding grants) from taxation, or about 15 to 16 percent of GDP. The relatively low tax collections (albeit high by SSA standards) reflect the negative impact on the tax base of the economic dependence on agriculture and the large informal sector relative to the formal sector.[34] Tax collections have strengthened in recent years since the introduction of new policy and administrative measures, including the establishment of the Malawi Revenue Authority in 1999.

Direct taxes grew from about 35 to just over 40 percent of total revenues over the 1990s (7.4 percent of GDP), while indirect taxes increased to over 50 percent during the latter 1990s (8.7 percent of GDP). Taxes on international trade declined from 27 percent of total revenues or 4.7 percent of GDP in the early 1990s to 14 percent of revenues, 2.6 percent of GDP, reflecting the continued reduction of trade tariffs and barriers, including on manufacturing inputs and agricultural hand tools. Over the corresponding period, taxes on goods and services remained around one-third of total revenues. See also Table 4.5 below.

[31] World Bank, Malawi Country Brief, Nov 2003
[32] World Bank, Malawi Country Brief, Nov 2003
[33] World Bank, Malawi Country Brief, Nov 2003
[34] IMF, Malawi: Selected Issues and Statistical Appendix, August 2002

Taxes on goods and services are principally the surtax on manufactured goods, imports and selected services (excludes financial services) and a range of excise duties and raised 5.7 percent of GDP in the early 1990s increasing to 6.5 percent of GDP on average later in the decade to 2001. The credit method surtax, which evolved from a single-stage manufacturer's level sales tax, has been in place since 1989 under the Customs and Excise Act. The credit-method surtax is effectively a credit-method VAT on imports of goods and domestic production through the manufacturing level plus a range of services.[35] The surtax was extended in September 2002 to the retail stage with the introduction of the Surtax Act No. 14 of 2001. Registrants have increased fivefold since 1989,[36] but with the move to the retail level the minimum turnover for compulsory registration was raised from MK 75,000 (about US$1,000) to MK 2,000,000 (about US$27,000 in 2002) per annum. The new threshold is expected to have a positive impact on revenue since the former threshold was not strongly enforced.[37] A standard rate of 20 percent applies with few exemptions, notable inputs, food items (including maize), social services and farm produce. A reduced rate of 10 percent applies to the supply of residential electricity, hotel accommodation and related services. Zero rated items include exports, pharmaceutical products, medical services, fertilizers, and condoms.

Since 2000/01 budget, a number of tax policy changes were made to improve efficiency, collections and progressivity in the tax system. Changes to the surtax and excise taxes included: the replacement of the surtax on petrol products with excise duties, zero rating of milk, salt, exercise books, and capital inputs for manufacturing and the extension of the surtax to the retail stage in 2002[38].

The excise tax structure ranges from 10 to 100 percent. Excise duties were also recently extended to select consumer goods and increased on select motor vehicles, alcohol and cigarettes. The measures have led to an increase of over 150 percent in excise tax collections from 0.7 of GDP in the 1990s to 1.8 percent of GDP by 2001–2002. Some of the changes in the tax policy between 2000/01 and 2002/03 reflect reversal of measures, for example rates on alcoholic beverages were raised by 20% in FY2000 and then lowered by 25% the following year and increased again in the next year.

[35] IMF, August 2002
[36] ref vat workshop doc..
[37] IMF, August 2002
[38] IMF, August 2002

Table 4.5. Malawi, Budget Aggregates and Revenue Composition, Averages for 1992/93-96/97 and 1997/98-2001/02

(Fiscal Year beginning April 1)

	Percentages	
	1992/93-96/97	**1997/98-2001/02**
Total expenditures (including net lending) as share of GDP	31.1	29.8
Total Revenue + Grants as share of GDP	22.6	23.6
Overall surplus (deficit) as share of GDP	-8.6	-6.2
Revenue sources as shares of (Total revenue + Grants)		
Grants	25.3	27.7
Non-tax revenue	7.3	6.6
Tax Revenue	67.4	65.7
Indirect Taxes	46.7	36.8
Surtax	22.6	21.8

Mauritius

Mauritius has developed from a small island economy overly dependent on the sugar industry for employment and export earnings to a diversified economy with strong performances in tourism, financial services, and textile manufacturing. It has emerged as the economy with the highest per capita GDP at US$3,751 in 2001 among the SADC Member States (see Table 2.2.). Real economic growth was particularly strong in the late 1980s at an average of close to 8 percent annually. Investments in export processing zones proved to be successful and this sector soon rivaled government and the sugar industry as one of the leading employers in the economy, employing around 18 percent of the total employed population in 1999 compared to 7 percent for sugar workers.[39] Though growth slowed during the 1990s, it remained around 5 percent, benefiting from preferential trade arrangements for its main exports, sugar and textiles. After a slump in 1999/2000, the economy seems poised to rebound once again, though uncertainties in the sugar and textile markets can dampen the outturn. Imports are a high, but declining share of GDP over the past decade, recording just over 50 percent of GDP in the last five years. Private consumption is relatively low as a share of income compared to other SADC countries, just over 60 percent of GDP. Despite the success of the government's economic strategy, including the containment of inflation to single digits over the past two decades, unemployment has been increasing over the past ten years, reaching close to 10 percent by 2002, partly reflecting a mismatch between available skills and the skills demanded in the changing economy.[40]

Fiscal performance has been stable for the past decade or so, but has begun to slip since the late 1990s, partly reflecting increases in capital spending. Overall fiscal deficit including grants averaged 5.5 percent of GDP. Total revenue and grants for fiscal years 1998–2002 were 21.4 percent of GDP, of which grants were only 0.2 percent of GDP. Revenue actually declined from around 22 percent on average during 1985 to 1995, averaging 19.5 percent of GDP during 1997 - 2001. Government expenditure has remained around 22 percent of GDP throughout the 1990s. Including net lending, government expenditures have averaged over 25 percent of GDP in the five years before 2002.

Mauritius drew 90 percent of its revenues from taxation during 1985–1995, but this share declined to 85 percent in the late 1990s and up to 2001. Non-tax revenues average around 2.5 percent of GDP, of which 70 percent represents property income. Tax revenues averaged 19 percent of GDP in the late 1980s and increased to 20 percent in the early 1990s. However average tax collections has declined to just over 17 percent of GDP in the late 1990s through 2001.

A declining share of government's revenues has been sourced from international trade, down from 41 percent during the late 1980s to 25 percent in 2001. Import duties declined from an average of 8.6 percent of GDP during 1985-1995 to 6.3 percent in the last five years through 2001, and are down to 5.1 percent of GDP in the FY 2002. The pattern of collection of taxes from income, however, showed an increase, rising to 2.8 percent of GDP in the first half of the 1990s (12.8 percent of

[39] IMF, Mauritius: Selected Issues and Statistical Appendix, October 2003
[40] IMF, October 2003.

total revenues) before declining to 2.5 percent of GDP (12.4 percent of total revenues) in more recent years. Mauritius had a sales tax at 5% in 1983 and raised the rate to 8% in 1996. In contrast with the movements in international taxes, taxes on goods and services have been growing in importance in Mauritius from 14 percent of government revenues in the early 1990s to over 40 percent by 2000. As a share of GDP, they have increased from about 2 percent in the early 1990s to over 5 percent by 2002 after the VAT was introduced in 1998 at 8%. The VAT appears to being used as a revenue substitute for import duties.

Taxes on goods and services include a value added tax, excise taxes on alcohol and tobacco products, as well as locally manufactured motor vehicles, taxes on gambling, company registration fees and motor vehicle taxes. Excises taxes on diesel and several license fees were increased in 2002.

Value added tax was introduced in 1998 and replaced the sales tax on goods with a standard rate of 8 percent previously in place since 1983. The VAT is currently chargeable at a standard rate of 15 percent on the domestic supply of goods and services as well as the importation of goods (except for imports into the free port zone).[41] The rate was only recently increased from 12 percent in the 2002/03 Budget. Exports are zero rated, as is water and electricity since October 2000. Other zero-rated items include basic food items (wheat flour, wheat bran, edible oils, margarine, sterilized liquid milk, curdled milk and cream, yoghurt and common salt), sugar, live poultry, fertilizers, electricity, water and sewage services, books and other printed matter, transport of goods by sea or air. Exempted goods include basic foodstuff, medical supplies, fishing vessels and aircrafts services, agriculture inputs such as fertilizer and animal feed, air and sea passenger transportation, educational and training services, financial services, sale of land and residential buildings and companies with turnover below Rps 3 million.

Further changes to the value added tax structure were introduced in 2003/04 Budget, broadening the base to include previously zero-rated or exempted items and activities.[42] Categories where the tax will be applied include a number of food items, including cereals, cooking oils, agriculture and horticulture produce, medical services and pharmaceutical produces, education services, water and electricity. The revenue impact of these measures is estimated at 1.2 percent of GDP.[43]

[41] IBFD, September 2002
[42] IMF, Mauritius, Article IV Consultations and Staff Report, October 2003
[43] IMF, Mauritius, Article IV Consultations and Staff Report, October 2003

Table 4.6. Mauritius, Budget Aggregates and Revenue Composition, Averages for 1992/93-96/97 and 1997/98-2001/02

(Fiscal Year beginning July 1)

	Percentages	
	1992/93-96/97	**1997/98-2001/02**
Total expenditures (including net lending) as share of GDP	25.8	26.9
Total Revenue + Grants as share of GDP	20.6	21.4
Overall surplus (deficit) as share of GDP	-5.2	--5.5
Revenue sources as shares of (Total revenue + Grants)		
Grants	1.0	0.8
Non-tax revenue	13.4	14.7
Tax Revenue	85.6	84.4
Indirect Taxes	53.2	55.8
Sales Tax/ VAT	9.6	22.1

Mozambique

After emerging from a 15-year civil war in the early 1990s, Mozambique was set to become the next success story in Southern Africa. Despite extensive damage to their economic infrastructure as a result of the war, the country has managed to maintain growth rates averaging around 8 percent during 1993–2002. The economic progress made was mainly a result of far reaching economic reforms on the legal and regulatory side as well as market based economic policies under IMF/World Bank agreements that boosted foreign investment and exports. Inflation has declined from averaging over 50 percent in the mid 1980s to mid 90s to 14 percent during the last half of the 1990s. The country's major growth sectors are agriculture, which occupies over 80 percent of the population, coal mining and construction. Agriculture has nonetheless been declining as a share of GDP in favor of industry. Private consumption has also declined from over 100 percent of GDP before 1994, to 68 percent by 2001.

Overall fiscal performance has been generally commendable reflecting the government's prudent approach to economic management. Nonetheless, the cost of reconstruction has placed a heavy burden on the country's fiscal resources. The fiscal deficit worsened over the 1990s, widening from an average of 10 percent of GDP between 1993 and 1997 to an annual average of 12.6 percent over next five years. See Table 4.7. Total revenues and grants averaged of 22 percent of GDP over the past decade, with grants forming 46 percent of these revenues, which is the highest grant to revenue proportions in the region (see Table 5.5.) Expenditures on the other hand has averaged 22 percent of GDP during 1993-1997, increasing to 27 percent in the past five years, of which close to 55 percent is externally financed (See Table 5.5), the largest external financing proportion of the SADC countries. A significant part of the expenditure (12 percent) reflects workers' compensation as the government has increased wages and salaries and increased public employment in the social sectors as part of the poverty alleviation policies.

Grants have sharply increased in recent years, now close to the level of total revenues at 10 percent of GDP for the decade, 1998–2002, compared to revenues, which are 12 percent of GDP.

Mozambique derives over 91 percent of their own-source revenues from taxation. Over half of tax revenues are sourced from taxes on goods and services and this proportion has been increasing in recent years. In contrast, taxes on income as well as on international trade have been a declining share of revenues during the 1990s, 17 percent to 16 percent and 22 percent to 16 percent, respectively comparing the averages for 1993–1997 and 1998-2002. Non-tax revenues have increased over the 1990s to reach over 11 percent of revenues after 2000, reflecting proceeds from privatization and increased social security contributions. See Table 4.8.

Taxes on goods and services are a major source of revenue for Mozambique and have increased from an average of 49 percent of revenues during 1993–1997 (5.8 percent of GDP) to 56 percent of revenues (6.9 percent of GDP) during 1998–2002. Taxes collected included the turnover and consumption taxes until June 1999, when they were replaced by a value added tax. Other taxes on goods and services include selective excise taxes, including taxes on petroleum products.

The VAT is levied on the sale of goods and services in Mozambique by entrepreneurs and on the importation of goods at a standard rate of 17 percent. Zero-rated items, or items exempt with credit are exports, imports of ships and aircraft for international trade, chartering services, international travel[44]. Exemptions are granted without credit in respect of certain transactions including select passenger vehicle services, purchase of motor vehicle fuel and half the cost of automobile diesel, travel and entertainment expenses of the entrepreneurial activity, and purchase of second-hand goods and art objects for resale.[45] Other exempt activities include health, education and welfare related activities; supplies of NGOs; copyright and art objects by creators or heirs; stamps and paper, burial services, garbage removal; finance, immovable property, insurance, betting and gaming transactions; basic foodstuff; agriculture and fisheries supplies.

Excise duties are charged on the sales price plus other taxes of listed goods including alcohol and tobacco products, perfumes and cosmetics, precious stones, animal skins and furs, cars, pleasure vessels, firearms and ammunition. Collections have averaged 1.2 percent of GDP or 10 percent of revenues in the past decade.

The government and IMF have reported that the revenue impact since 1999 has been in line with expectations.[46] Collections of VAT since its introduction has averaged 5 percent of GDP compared to the average collection of turnover taxes of 3 percent from 1993 – 1999. Nonetheless, the tax administration and taxpayers continue to face difficulties in effecting the refund system. For example, only about 30 percent of refunds were paid in 2003.[47]

Reforms since 2002 included a new code on the personal and corporate tax structure, new elements in the fiscal incentive structure and a new vehicles tax. In 2003, the specific tax on domestic petroleum products was increased to adjust for inflation. A new measure is to be introduced in 2004 to make this adjustment automatic.

[44] IBFD June 2002
[45] IBFD June 2002
[46] IMF, Republic of Mozambique, Article IV Consultation – Staff Report, March 2004.
[47] IMF, March 2004

Table 4.7. Mozambique, Budget Aggregates and Revenue Composition, Averages for 1993-97 and 1998-2002

(Fiscal Year end December 31)

	Percentages	
	1993-97	**1998-2002**
Total expenditures (including net lending) as share of GDP	22.1	27.4
Total Revenue + Grants as share of GDP	21.9	23.1
Overall surplus (deficit) as share of GDP	0.2	-2.0
Revenue sources as shares of (Total revenue + Grants)		
Grants	46.3	45.9
Non-tax revenue	4.5	5.1
Tax Revenue	49.2	49.0
Indirect Taxes	40.0	40.4
Turnover Tax/ Value Added Tax	3.4	4.5

Namibia

Namibia is a middle-income country with real economic growth of 4.7 percent in the decade to 2001. For a relatively young country, only gaining independence in 1990, Namibia has grown rapidly benefiting from favorable relations with South Africa, a rich natural resource base and strategic location on the coast. The economy is dominated by the tertiary sector, 55 percent of GDP, particularly services related to trade, tourism and transportation, and the primary sector activities of commercial livestock farming, fishing and mining, over 21 percent of GDP. Namibia is a member of the Common Monetary Area and SACU and is dependant on the South African economy for over 85 percent of it imports.[48] Final consumption averaged 88 percent of GDP over the 10 years to 2002, while imports amounted to 55 percent of GDP.[49]

Total revenue and grants remained stable through the 1990s to 2001 at an average of 33 percent of GDP. Expenditures were also fairly stable at around 36 percent of GDP for the decade. The pattern of government spending has however shifted in favor of current expenditures, although development spending continues to average around 5 percent of GDP or 14 percent of total expenditures. The overall deficit has improved in recent periods as a result of the relatively better revenue performance, mainly, and has declined from 3.9 percent of GDP during 1992 – 1997 fiscal years to 3.1 percent in the five years to 2001. Grants declined through the 1990s from 1.6 percent of GDP at independence to 0.2 percent by 2001.

Over the 1990s, Namibia has increased the proportion of its revenues sourced through taxation, from 87 percent in the first half of the decade to over 90 percent by 1998. Tax revenues are almost evenly sourced across income, international trade, and goods and services. Income taxes have remained strong at around 10 percent of GDP, rising from 27 percent of revenue and grants in 1992 to 36 percent by 2002. Concurrently, indirect taxes have been declining somewhat as a share of total revenues, but the introduction of the VAT in 2000 boasted the sales tax revenues. Non-tax revenues declined from 11 percent of GDP to 9 percent between the first to the second half of the 1990s. See Table 4.8.

As a member of SACU, Namibia pays over customs and excise duties to the SACU pool. Duties levied in South Africa are applicable in Namibia. Namibia's revenue from SACU totals 9.9 percent of GDP or one-third of total revenue collections. This proportion is expected to decline under the new revenue sharing arrangements (see Table 5.5.)

The sales tax, previously in place since 1992, had been levied at 10 percent at the retail stage on goods and services, including imports. Exemptions were applied to basic foods, mainly maize and millet meal; sales intended for resale by certified buyers; water, postal, telecommunication and transport services; certain land and building transactions; exports of goods; and select services. Firms with annual sales of more than N$50,000 were required to register. Additional sales levies were introduced in 1996 to broaden the base and increase revenues and these succeeded in increasing sales tax revenues to 20 percent of revenues from 18 percent (an increase of one

[48] http://www.mti.gov.na/econvnv_text/macroeconomic_overview.htm
[49] Institute for Public Policy Research, http://www.ippr.org.na/database.HTM

percent of GDP). The additional levies were applied at four rates, 5, 10, 15 and 25 percent and the threshold for registration increased to N$200,000. The highest rate applied to alcohol and tobacco products and the lowest to foods. The high rate was dropped as of October 1, 2002

A multiple-rate value added tax replaced both of the former sales structures in November 2000, but the effective tax rate was designed to be comparable with the former rates, but the standard rate was raised to 15%. The high rate of 30% was subsequently dropped in 2002. VAT collections for climbed from 4.9 percent in 1999/2000 for the sales tax to 5.8 percent in 2000/01 to 6.9 percent in 20001/02, but have subsequently moderated to 6.4 percent of GDP in 2002/03. This compares favorably to the average of 4.6 percent of GDP for the sales taxes and additional levies between FY1995–1999.[50] Overall the VAT appears to have resulted in about a 39% increase in revenues compared to the sales tax and levies, but with a 50% increase in the standard tax rate which suggests a price elasticity of demand of about –1.2 for the tax base. Three main rates are levied, a standard rate of 15 percent, a higher rate of 30 percent and a zero rate. Zero rated items included electricity and sanitation services, fuel, international transportation and cargo services. Exempt supplies, in addition to most of those previously exempted, but not zero rated under the sales tax, include medical and educational services, nursing homes and residential accommodation, public transport services, financial services and services by trade unions. Certain imports were also exempt including supplies to EPZ enterprises.

Table 4.8. Namibia, Budget Aggregates and Revenue Composition, Averages for 1992/93 - 96/97 and 1997/98 – 2001/02

(Fiscal Year beginning April 1)

	Percentages	
	1992/93–96/97	**1997/98–2001/02**
Total expenditures (including net lending) as share of GDP	35.8	36.1
Total Revenue + Grants as share of GDP	32.5	33.0
Overall surplus (deficit) as share of GDP	-3.3	-3.2
Revenue sources as shares of (Total revenue + Grants)		
Grants	1.5	1.1
Non-tax revenue	11.2	8.6
Tax Revenue	87.3	90.3
Indirect Taxes	57.5	54.3
General sales tax/VAT	15.3	16.2

[50] IPPR, http://www.ippr.org.na/database.HTM

South Africa

The South African economy has grown in real terms at an annual average of 3 percent since 1995, remaining one of the largest economy in Africa and one of the larger economies in the world,[51] with economic output in 2001 twice the total of all the other member countries of SADC (see Table 2.2 above), though ranking behind Mauritius and Botswana in per capita GDP. The structure of the economy has also evolved from agriculture (now less than 5 percent of GDP) and mining towards manufacturing (close to 20 percent of GDP) and financial and tourism services, with the largest share of GDP, 64 percent, sourced from the service sector. The mining sector however continues to account for a significant share of exports, and the mining and agriculture sectors employ around 17 percent of the working population.[52] Total consumption through the 1990s has averaged 83 percent of GDP, with private consumption growing at an average of 3.3 percent between 1995 and 1999, compared with the average growth of 1.25 percent in the first half of the decade. Inflation has slowed significantly over the decade from an annual average of 16 percent during the last half of the 1980s to 8 percent by the corresponding period in the 1990s. Economic development is challenged, however, by an unemployment rate of close to 30 percent and challenges to social structures caused by HIV/aids prevalence.

Overall deficit has declined through the 1990s, averaging less than 3 percent of GDP in the late 1990s and down to about one percent by fiscal 2002, with just only about 3 percent of the financing coming from foreign sources. Total revenues and grants initially declined in the first half of the 1990s then increased by 2.5 percent to 27 percent on average from 1998 to 2002. Government expenditures and net lending followed an opposing pattern, first increasing then decreasing by 2 percent to 29 percent of GDP in the corresponding periods. Expenditure on wages and salaries has declined most sharply from close to 12 percent in the late 1980s to around 5 percent in the latter half of the 1990s, but subsidies and transfers have increased to mitigate close to 70 percent of the decline in personnel spending. Foreign financing of government spending has also increased in recent years, from 1.5 percent to over 4 percent between the first half to the last half of the period 1992–2001. Grants, at 0.1 percent of GDP, are a declining proportion of foreign financing.

Average annual tax revenues totaled just over 22 percent of GDP in the early 1990s, but increased to 25 percent during 1997 to 2001. Over eighty percent of the increase came from increased collections of income taxes. In fact, income taxes increased from 12 to 14 percent of GDP over the comparative period. Similar to other middle and higher income economies, income taxes are a major source of tax collections at an average of over 54 percent of total revenues since the 1980s, 59 percent in the most recent five years to 2001. International taxes comprise a declining share of total revenues, from close to 7 percent in the late 1980s (1.6 percent of GDP) to 3.5 percent in 2001 (0.8 percent of GDP). Taxes on domestic consumption of goods and services have averaged around 37 percent of total revenues, or 8.6 percent of GDP, in the ten years before 2001.

[51] Based on World bank Development Indicators 2005, using GDP measured in 2000US$, South Africa ranked 29 and based on purchasing power parity GDP measures, it ranked 19 in the world.
[52] http://www.economist.com/countries/SouthAfrica/profile.cfm

Taxes on goods and services comprised a consumption-type value added tax since 1991, specific and *ad valorem* excise duties, and levies on fuel and financial transactions. A small turnover tax (01% tp 0.2%) is also levied by the District and Joint Service Councils.[53] The value added tax is levied by the central government at a standard 14 percent rate on goods and services except for items selected for zero-rating. Zero rated items include exports, several unprocessed food items, petrol and diesel, several agricultural input, and international transport services.[54] Domestic exemptions include mainly interest based financial services, residential rents, passenger transport and educational services. VAT collections have increased as a share of GDP from 5.5 percent in the five-year period to 1996 to 5.9 percent on average in the five years before 2001. VAT collections, however, have declined in importance as a share of total revenue due to the increase share coming from income taxes, from an average of 25.3 percent from 1987–1991 to 24.9 percent during 1997-2001.

Excise duties are assessed at mainly specific rates against alcohol, tobacco and petroleum products, with specific rates being adjusted annually for inflation. *Ad valorem* duties are applied to various cosmetic and perfume products, and a range of other consumer products. Specific excises tax collections average around 1 percent of GDP while *ad valorem* excises are 0.1 percent and declining. Excise taxes are also a declining share of total revenues during the 1990s although still close to 5 percent. Fuel levies on the other hand have increased from 1.2 to 1.7 percent of GDP from the late 1980s to the 1990s, reaching 1.5 percent in 2001.

Customs and excise duties form part of the SACU pool and comprise just 4.3 percent of South Africa's revenues or 1.1 percent of GDP, the lowest share for SACU members.

Table 4.9. South Africa, Budget aggregates and Revenue Composition, Averages for 1992/93-96/97 and 1997/98-2001/02

(Fiscal Year beginning April 1)

	Percentages	
	1992/93-1996/97	**1997/98-2001/02**
Total expenditures (including net lending) as share of GDP	31.0	29.0
Total Revenue + Grants as share of GDP	24.1	26.6
Overall surplus (deficit) as share of GDP	-6.9	-2.4
Revenue sources as shares of (Total revenue + Grants)		
Grants	0.9	0.4
Non-tax revenue	6.6	5.8
Tax Revenue	92.5	93.8
Indirect taxes	37.7	36.2
General sales tax /VAT	22.8	21.1

[53] IMF, South Africa, Selected Issues, March 2000, Country Report 00/42
[54] IMF, March 2000

Swaziland

Swaziland is a small, middle-income country landlocked mainly by South Africa and dependant on it for most of its trade. The economic structure has diversified away from being agriculture-based in the 1980s, and manufacturing and services are increasingly important in driving economic growth. Nonetheless agriculture, particularly subsistence farming, continues to employ much of the population with 65% of the population living in rural areas. Agro-industry contributes more than 70 percent of export earnings of which sugar exports account for 80 percent. The manufacturing sector accounts for over 27 percent of GDP while services account for a further 32 percent share.

While overall revenue and grants have remained around 30 percent of GDP over the 1990s, expenditures have declined from an annual average of 33 percent of GDP during 1992 to 1996, to 29 percent in 2001. As a result the overall deficit has improved in recent periods from an average of 4 percent of GDP earlier in the decade to less than 0.5 percent of GDP in the five years before 2001. The overall balance in fact became positive during 1997 to 1999, reaching a high of 3.3 percent of GDP in 1999.

Around 93 percent of total government revenues were derived from taxation in the 1990s. Taxation is applied to income, sales of goods and services and trade. Taxes on income declined over the 1990s mainly reflecting reduced collections of corporate taxes and non-resident income and interests. Individual income tax payments actually increased over the same period. Indirect tax collections in contrast increased over the 1990s, growing from 61 percent of revenues on average, during 1992 – 1997, to 66 percent by 2001. Taxes on goods and services increased over the 1990s, reflecting increased collections in most of the sub-categories. Nonetheless, SACU declined as a proportion of indirect revenues from close to 77 percent of GDP on average during 1992 – 1996FYs to an average below 75 percent during 1997 – 2001FYs.

Taxes on goods and services comprise sales tax, selective excises, business and professional licenses, motor vehicle licenses and a fuel levy on petroleum products. The sales tax has been in place since 1983 and was levied at 12 percent until 2000 when it was increased to 14 percent on goods and select services imported or manufactured in Swaziland. A higher rate of 25 percent (previously 20 percent) applies to most alcoholic and tobacco products[55]. Exemptions include food necessities and intermediate inputs for manufacturing, inputs for farming and forestry purposes, certain medical supplies, temporary imports and imports of personal effects, electricity[56]. Exports as well as imports and manufactured goods for diplomatic and central government personnel are also exempt. Collections of sales tax has remained fairly steady at 14 percent of GDP over the past decade, equivalent to 12.6 percent of total revenues in the five years before 2001.

[55] IBFD, 2002
[56] IMF January 2003

Excise duties are levied at specific rates on un-manufactured tobacco, pure alcohol and petrol[57]. Excise and customs duties receipts are determined through SACU arrangements.

Table 4.10. Swaziland, Budget Aggregates and Revenue Composition, Averages for 1992/93 - 96/97 and 1997/98 – 2001/02

(Fiscal Year beginning April 1)

	Percentages	
	1992/93–96/97	**1997/98–2001/02**
Total expenditures (including net lending) as share of GDP	33.1	29.6
Total Revenue + Grants as share of GDP	29.9	33.0
Overall surplus (deficit) as share of GDP	-3.2	-0.5
Revenue sources as shares of (Total revenue + Grants)		
Grants	2.5	3.0
Non-tax revenue	5.0	6.5
Tax Revenue	92.5	90.5
Indirect Taxes	61.0	65.1
General sales tax/VAT	11.9	12.7

[57] IBRD, December, 2002

Tanzania

Tanzania is a low-income country with an average GDP per capita of USD183 over the past ten years, but with a growth rate that has improved in the past five years in the wake of economic reform, averaging around 4 percent annually. Since 2000, inflation has declined to single digits, averaging 6 percent during 2000 - 2002. The economy is heavily dependant on agriculture, particularly subsistence farming, and is vulnerable to adverse weather variations. Agriculture output contributes 43 percent of GDP and makes up around 75 percent of exports; though a significant portion of output is informal (monetary GDP is around 70 percent of total economic activity[58]). Growth in tourism over the latter 1990s led to increased economic activity in related service sectors, such as hotels, transport, communication and financial services. Imports are around 24 percent of GDP, while private consumption is 86 percent of GDP[59].

Over the decade to 2001, the overall deficit averaged 2 percent of GDP, higher in the latter five years than the former. Revenues declined from an average of 12.4 percent of GDP during the fiscal years of 1992 – 1996, to 11.8 percent during 1997 – 2001, one of the lowest rates in the East African region[60]. The decline reflects the erosion of the tax base as the government privatized and became more dependent on the private, mostly informal sector, for income tax receipts[61]. At the same time, tax incentives and exemptions to the mining and tourism sectors remain significant[62]. The government however had successfully constrained recurrent spending, which declined by over 2 percent of GDP over the same period, owing to the system of cash budgeting[63]. Civil service reform and the disciplines of IMF programs resulted in a decline in wages, goods and services. Interest payments also declined in part due to the increase in grant and foreign financing of development programs (over 90 percent of the capital budget is foreign financed). Grants at close to 4 percent of GDP, are equivalent to over 33 percent of total revenues.

Around 90 percent of Tanzania's revenues are drawn through taxation. Tax revenues averaged 11 percent of GDP during 1992 – 2001, with increases from the taxes on goods and services compensating for declines in trade and income tax receipts and non-tax receipts as shares of GDP. The growth in the value added tax has been mainly on the import side, specifically non-petroleum imports, which have an equivalent share of total revenues compared to VAT on domestic supplies; both are around 13 percent. VAT makes up over 25 percent of revenues, 29 percent in the five years before 2002. Excise taxes make up another 14 percent; import taxes around 10 percent and income taxes, 25 percent.

The Value Added Tax Act 1997 defines the structure of VAT in mainland Tanzania, and is payable on taxable supplies of goods and services and on imports. It replaced the multi-rate turnover tax in 1998. The VAT rate is applied at 20 percent, on the

[58] January 2003; IMF Selected Issues and Statistical Appendix, Country Report 03/2
[59] WDI 2003, World Bank
[60] January 2003; IMF Country Report 03/2
[61] January 2003; IMF Country Report 03/2
[62] January 2003; IMF Country Report 03/2
[63] The Economist Intelligence Unit;
HTTP://db.eiu.com/report_dl.asp?mode=pdf&valname=CRTZD701

mainland and in Zanzibar, except for those goods and services to which a zero rate is applied. Items which are zero rated include exports, the supply of goods for consumption on passenger vessels, transportation and shipping related services, local supply of human medicines, drugs and equipment[64]. The law provides that tax could be applied on imports from Zanzibar to bring the Zanzibar VAT rate in line with the rate on the mainland[65]. VAT exemptions on petroleum products were eliminated in 2000/01[66]. Three taxes apply to petroleum products: VAT, excises on VAT inclusive base and a fuel levy. Petroleum taxes, from which the mining is exempt, accounted for around 1.6 percent of GDP on average during FY1997 – FY2001.

The overall VAT efficiency rate of 0.2 still compares less than favorable with the average of 0.27 for Sub-Saharan Africa and mainly reflects the size of exemptions[67]. Exemptions are granted on 21 listed items including food, crop and livestock supplies (not for catering); pesticides and fertilizers; medical and health related supplies; educational supplies (including capital goods to government-registered establishments), printed matter; transport services (financial and insurance services; water and tourism[68]. See Tables 6.6 and 6.9 below. Relief is also granted to a number of exempt organizations, including government entities and NGOs, as well as inputs by entities previously exempt under the sales tax structure[69]. The government has since 2000 commenced efforts to streamline exemptions and reduce the revenue loss through customs and VAT reliefs[70].

An excise tax structure also applies to certain luxury manufactured products, including alcoholic products, cigarettes, petroleum products, motorcars exceeding 2000 cc and soft drinks[71]. Most rates are *ad valorem* except on motor vehicles, where a 10 percent rate applies and on mobile phone services which attracts a 5 percent tax rate. Excises were significantly simplified since 1999/00 from 52 to 6 rates and collections have remained around 9 percent of revenues on domestic goods and services during 1997 to 2001 fiscal years[72].

[64] IBRD, March 2003
[65] IBRD, March 2003
[66] January 2003; IMF Country Report 03/2
[67] IMF Country Report 03/2
[68] IBRD, March 2003
[69] IMF Country Report 03/2
[70] January 2003; IMF Country Report 03/2
[71] January 2003; IMF Country Report 03/2
[72] IMF Country Report 03/2

Table 4.11. Tanzania, Budget Aggregates and Revenue Composition, Averages for 1992/93 - 96/97 and 1997/98 – 2001/02

(Fiscal Year ending June 30)

	Percentages	
	1992/93–96/97	**1997/98–2001/02**
Total expenditures (including net lending) as share of GDP	17.7	17.4
Total Revenue + Grants as share of GDP	15.4	15.7
Overall surplus (deficit) as share of GDP	-2.3	-1.7
Revenue sources as shares of (Total revenue + Grants)		
Grants	19.9	24.9
Non-tax revenue	8.9	7.6
Tax Revenue	71.2	67.5
Indirect Taxes	51.5	49.8
General sales tax/VAT	19.6	24.7

Zambia

The Zambian economy has grown in real terms at an average of 2.4 percent annually over the past five years to 2002 compared to the average of -1.1 percent in the prior five-year period. More recently growth has increased to average 4.6% over the five years through 2005. The main exports are minerals, particularly copper. Zambia is the world's fourth largest copper producer and derives 68 percent of its export earnings from this mineral but just 8 percent of real GDP[73]. The agriculture sector contributes just 19 percent of GDP but employs the majority of the workforce. Manufacturing has declined since the early 1990s; from 33 percent of GDP in 1991 to just 10 percent by 2001. The services sector contributes over half of GDP, mainly from wholesale and retail activities, which also attracts a large amount of informal economic activity.

Private consumption has also grown as a share of GDP from around 65 percent in the latter half of the 1980s, to close to 80 percent annually during 2000 – 2001. Inflation has slowed from triple figures in the mid 1990s, but remains around 24 percent annually during 1997 – 2001. The main causes of the high inflation are lax fiscal policy, weak exchange rates, and weather related fluctuations in food harvests and prices. The overall budget deficit has remained around 4 percent of GDP during 1997 – 2001, an improvement from the average of 6 percent in the previous five years. Year to year fluctuations in the deficit are usually very sharp reflecting poor fiscal planning and a consistent over-budgeting of donor assistance[74]. High tax rates leave little scope for increasing revenue collections although the government hopes to achieve this through improved administration by the semi-autonomous Revenue Authority.

Revenue and grants have declined over the past ten years from 29 percent of GDP in the first half of 1992 -2001 to 25 percent in the second half of that decade, mainly reflecting lower receipts of grants since revenues were stagnant around 19 percent of GDP throughout the period. Tax revenues increased as a share of total revenues over the comparative period from 94 percent to 97 percent. This increase is attributable to substantial increases in personal income, which rose from 20 percent of total revenues (3.9 percent of GDP) during 1992 – 1996 to 30 percent by 2001 (5.7 percent of GDP). Company income taxes lost some significance over the decade, as did trade taxes, though the latter remains important to revenues at close to 30 percent of total collections.

Taxes on goods and services include the Value Added Tax since 1996, *ad valorem* excises on alcoholic beverages, tobacco products, hydrocarbon oil, mineral water and soft drinks, tires and the fuel levy, a specific excise on the wholesale price of gasoline[75]. The VAT in Zambia is applied at a standard rate of 17.5 percent, except for items scheduled to be zero-rated. Exemptions include the standard exemptions of food items, educational and health services as well as financial, residential real estate and transport services. Diplomatic and other foreign missions are also exempt from both VAT and excises.

[73] Zambia Economic Structure; http://www.sunvil.co.uk/africa/zambia/guidebook
[74] EIU Zambia Country Profile, 2003;
http://db.eiu.com/report_dl.asp?mode=pdf&valname=CPZMD801
[75] Zambia, Summary of the Tax system as at July 1, 1997; Annex 1

From a sales tax to VAT during the 1990s, revenue collections were around 15.5 percent of the total or 3 percent of GDP. Excise tax collections are also around 3 percent of GDP but while VAT collections declined somewhat in recent periods, excises have strengthened (albeit by a difference of less than .1 percent of GDP). It is not clear as yet whether this is a new trend in collections.

Table 4.12 Zambia, Budget Aggregates and Revenue Composition, Averages for 1993 - 97 and 1998 – 2002

(Fiscal Year ending Dec 31)

	Percentages	
	1993–97	**1998–2002**
Total expenditures (including net lending) as share of GDP	33.1	27.8
Total Revenue + Grants as share of GDP	27.5	23.5
Overall surplus (deficit) as share of GDP	-5.6	-4.3
Revenue sources as shares of (Total revenue + Grants)		
Grants	29.6	25.9
Non-tax revenue	4.5	1.7
Tax Revenue	65.9	72.4
Indirect Taxes	45.0	45.0
General sales tax/VAT	14.4	21.9

Zimbabwe

Zimbabwe is a low-income country with average per capita income of USD620 in the decade to 2002. However, income has been declining since 1998, with negative growth rates deepening each year, reaching 12.8 percent in real terms in 2002. After a steady decline in the early 1990s, inflation has begun to speed up since 1995 reaching over 70 percent by 2001. Private consumption is lower than most countries in the region at around 67 percent of GDP in the latter 1990s to 2001.

Zimbabwe's total revenues including grants increased from an average of 27.5 percent of GDP during the fiscal years of 1991 to 1995 to 31.2 percent of GDP during 1996 to 2001. Notwithstanding this improvement, total expenditures increased more than proportionately over the corresponding period resulting in a widening of the overall deficit before grants from 8.8 percent of GDP to 12.2 percent. Even as grants declined in the latter 1990s, Zimbabwe began to accumulate foreign interest arrears. The latter averaged 0.6 percent of GDP during 1996 – 2001, covering close to 2 percent of the deficit.

Tax revenues comprise over 93 percent of total revenues in Zimbabwe, up from 90 percent in the first half of decade to 2001. Individual income tax have increased by close to 9 percentage points since 1991 to reach over 40 percent of total collections, or 11.5 percent of GDP, by 2000. In contrast income tax from companies has fallen to 10 percent of revenues (around 3 percent of GDP) from over 17 percent (4.6 percent of GDP) in 1992.

Indirect taxes averaged over 11 percent of GDP over the decade 1991 – 2001, mostly reflecting sales taxes on domestic goods. Customs duty collections declined by 0.7 percentage points of GDP comparing the first to the latter half of that decade. Sales taxes and excise duties increased steadily over the decade averaging around 5 percent of GDP over the decade (18.7 percent of total revenues) and reaching close to 6 percent of GDP by 2001, (22 percent of total collections). Other taxes collections received a boast of 0.5 percent of GDP from the collection of tobacco levy from 1995FY.

The single-staged sales tax in Zimbabwe had been in place since 1976. In 2004 it was replaced by a Value Added Tax. The sales tax was applied on all goods sold locally, as well as services, at a standard rate of 15 percent. A 25 percent rate applied to motor vehicles whole a 10 percent rate applied to commercial vehicles listed and the supply of electricity. Registration was compulsory on all auto dealers, auctioneers and financial agents, service traders with over Z$500,000 in turnover and goods traders with turnover over Z$2.5 million; it was voluntary for traders below Z$2.5 million but over Z$250,000. Registered traders in the 'ring' system are exempted from payment of sales taxes. Exemptions could be granted through discretion by the Minister and also included exports, agriculture output by select farmers, goods for resale, goods for manufacturing input or packaging, goods for use by a miner in mining, and construction material. Certain food items were also exempt including bread, milk, maize, paraffin oil and livestock. When the VAT replaced the sales tax, the minimum annual turnover for compulsory registration was set at Z$250 million and voluntary registration was allowed for turnovers over Z$200 million.

Table 4.13. Zimbabwe, Budget Aggregates and Revenue Composition, Averages for 1993 - 97 and 1998 – 2002

(Fiscal Year ending June 30 till 1997, December 31 from 1998)

	Percentages	
	1992/933–96/97	**1998–2002**
Total expenditures (including net lending) as share of GDP	33.6	41.3
Total Revenue + Grants as share of GDP	27.1	31.3
Overall surplus (deficit) as share of GDP	-6.5	-10.0
Revenue sources as shares of (Total revenue + Grants)		
Grants	6.2	2.5
Non-tax revenue	10.4	6.0
Tax Revenue	83.4	91.5
Indirect Taxes	39.1	39.6
General sales tax	16.6	20.6

V. Identification of fiscal problems in more detail

Consumption taxes, and the VAT in particular supported by selective excise taxes represent a major source of central government revenues in SADC countries. What are some of the dimensions of the revenue challenge that VAT may be expected to meet? As outlined above, governments face a range of fiscal challenges arising from changes in trade tax regimes, the need to eventually substitute for aid flows, and the need to bring deficits under control. What is the nature and height of these fiscal hurdles?

Consumption taxes as a substitute for trade taxes: expected efficiency and revenue gains

VAT is ultimately a tax on final consumption. It does not tax capital investment and intermediate goods. If VAT is used as a substitute for import taxes on final consumption goods, then to the extent that these goods are also produced domestically the tax base of the VAT is larger than that on imports. In addition, the price of these tradable goods will be determined by the world market such that *if VAT replaces the import duty at an equal rate* no change in the price will be faced by domestic consumers. With the larger tax base, the VAT can collect more taxes without raising the consumer price. At the same time the effective subsidy to domestic producers from trade protection in the product market is removed along with the economic efficiency losses caused by this protective subsidy. Therefore, higher revenues can be raised at a lower economic efficiency cost per unit of revenues. This describes the typical economic efficiency and revenue gains expected from using consumption taxes to substitute for trade taxes.

By contrast to this typical situation, it is common for reforms in trade regimes to result in situations where the changes in the import taxes do not lower the domestic prices of tradable goods faced by consumers. For example, when the VAT is imposed at a rate higher than the customs duty it is replacing as a source of revenue, the prices faced by consumers increase and the consumption base is reduced, making it more difficult for the VAT to replace the forgone revenues. This situation arises variously for SADC Member States.

Changes in trade tax regimes: SADC and SACU

As outlined above, SADC has a timetable to achieve a Free Trade Area (FTA) by 2008, a Customs Union by 2010, a Common Market by 2015 and Monetary Union by 2016. SACU is already a customs (and excise) union.

SADC countries face a range of different types of revenue risks from these anticipated changes in their trade tax regimes.

Revenue losses resulting from establishing a common market

One type of revenue loss arises from the creation of trading blocs (free trade areas or customs unions or common markets) in which the customs duties on internal trade between member countries is foregone. The creation of the SADC FTA will result in revenue losses for the Member States. The implementation of the new SACU agreement also poses a different set of revenue risks to some SACU (also SADC)

members, particularly the Botswana, Lesotho, Namibia and Swaziland (BLNS) countries.

Revenue losses resulting from tariff changes

Another type of loss comes about with the trade liberalization in the *external* tariff. Such changes in the tariffs on final and intermediate goods, however, can be more or less easily substituted for by consumption taxes.

Loss in revenues from lowering *internal* tariffs, however, poses a more challenging problem than losses from lowering *external* tariffs. When *internal* tariffs are lowered, but external tariffs remain unchanged, then the price level within the common market relative to the prices in rest of the world remains unchanged, and therefore, increases in consumption taxes will raise domestic prices causing consumption to be squeezed. In addition, creating a free trade area behind external trade barriers causes trade diversion away from imports charged at the external tariff towards goods produced within the area that do not pay trade taxes, increasing revenue losses. To some extent these are recaptured through higher income taxes on expanded production within the region.

By contrast, when *external* tariffs are lowered on final consumption goods, domestic prices fall, allowing room to raise consumption taxes to recoup the revenues without raising prices above their prior level. This is not the case when tariffs are lowered on imports of intermediate inputs as the consumption tax, such as a credit-method VAT, is deductible on intermediate inputs so such the customs revenues have to be replaced by consumption taxes on final goods which raises domestic prices, squeezing demand.

SADC free trade area (FTA) agreement

Under the SADC Trade Protocol signed in 1996, the establishment of a free trade area has been agreed. The internal tariffs are to be eliminated in a phased manner by 2012.[76] SACU markets are generally expected to be open to non-SACU members by 2008, and the reciprocal arrangement by 2012. Table 5.1 shows some of the SADC non-SACU members are heavily dependent on revenues customs duties.

The highest customs dependence among non-SACU members is Mauritius, but it has been gradually reducing its dependence, that is import duties have dropped from 9.5% of GDP or 42% of total revenues in 1992 down to 5.1% of GDP or 25% of total revenues in 2002. The VAT introduced in 1998 has been systematically used to replace the customs revenues.

Amongst the other non-SACU countries, only the countries of Malawi, Mozambique, Zambia and Zimbabwe have significant import duty revenues at over 2% of GDP. These countries also import large shares of the imports from South Africa and can expect to lose a third or more of their customs revenues, or from about 0.7% to 1.3% of GDP. The other non-SACU countries can expect to lose less than 0.5% of GDP.

[76] World Trade Organization, Trade Policy Review: Southern African Customs Union, Report by the Secretariat, WT/TPR/S/114, 24 March 2003, pp 13-14.

The SACU members are highly dependent on customs revenues, except for South Africa and to a lesser extent Botswana. Given SACU imports from the other SADC members are relatively small, SACU members will not suffer much as a result of the lowering the internal tariff within SADC. The BLNS countries have already long since lost any internal trade protection within SACU.

Conclusion

As illustrated above it is important to distinguish between the losses of revenues that arise from reduction of tariffs on *internal* trade, from those which arises from *external* tariff liberalization. In the latter case, where the tariff reduction results in reductions in the domestic prices of final consumption goods, it is easier to raise consumption taxes to replace import duties. Where trade agreements reduce *internal* trade tariffs, domestic price do not necessarily fall, and hence, replacing customs revenues with consumption taxes, such as VAT, is more difficult.

New SACU agreement: effect on revenue income

Under the new SACU Agreement signed in October 2002 (but still awaiting ratification by all member countries), the revenue sharing formula will change. Under the current formula, which has been used since 1969 with the addition of a stabilization formula in 1976, customs and excise revenues have been collected into one SACU pool managed by South Africa. The BLNS countries have each been paid a share of the pool based on their gross-of-tax imports both from other SACU members and non-SACU member countries. The BLNS countries each receive revenues based on an adjusted duty rate equal to 1.42 times the effective duty rate for the overall SACU pool. In addition, the stabilization formula guarantees the adjusted effective duty rate falls between a minimum of 17% and maximum of 23%. This has resulted in the BLNS countries in nearly all years receiving 17% of their gross-of-tax imports. South Africa has retained the balance after payments to the BLNS countries.

Table A.1 in Appendix A shows the customs and excise collections received by the SACU pool and the shares paid out to the BLNS countries over 1989/90 through 2000/01. On average over the last five years BLNS countries were receiving about 40% of SACU revenues, but this constituted only 8.4% of SACU GDP. The weights in favor of the BLNS country shares of SACU revenues have reflected the loss of revenues suffered by these countries given the trade imbalance between South Africa and the BLNS countries. This disproportional share of revenues has been appropriate for sharing customs duties, but not excise duties. In addition, Table A.1 shows an increasing share of SACU revenues coming from excise duties, rising from below 40% to about 55% of revenues.

In the new revenue sharing formula the SACU pool is split into a separate customs pool and an excise pool. The customs revenues will be shared in proportion to the imports from SACU countries as a share of all intra-SACU trade, while 85% of the excise pool will be shared in proportion to GDP and the remaining 15% will be split between the SACU members with a small adjustment of 2% of the of the relative

difference of the per capita GDP from the SACU average.[77] A recent WTO review of SACU trade policy estimated the revenue shares based on 1998/99 data trade and GDP data. See Appendix A. Table 5.2 shows the impact of the new formula using these weights and comparing the results with the actual shares under the current formula on average during the five years of 1996/97-2000/01.

Table 5.1: Revenues from Customs Duties for SADC Member States as Share of GDP and Share of Total Revenues, Average for Fiscal Years, 1997- 2001

			Customs duties as share of GDP	Customs duties as share of total revenues
		Percentage		
Non-SACU members				
Angola			1.7	4.5
DRC			1.6	26.1
Malawi			2.7	18.7
Mauritius			6.0	29.5
Mozambique			2.1	17.0
Tanzania			1.5	12.3
Zambia			2.4	13.1
Zimbabwe			3.9	14.0
SACU members	SACU revenue as share of GDP	SACU revenue as share of total revenue		
Botswana	5.5	12.7	2.4	5.5
Lesotho (%GDP)	21.4	48.6	9.4	21.3
Lesotho (%GNDI)	14.8		6.5	
Namibia	9.9	30.6	4.3	13.4
Swaziland	14.3	49.8	6.2	21.7
South Africa	1.1	4.3	0.5	1.9

Implications of the new SACU formula

The new revenue sharing formula will more than double the share that the BLNS countries receive from the customs duty pool compared to the current combined SACU pool, but will lose more than half their share coming from the excise revenue pool. Correspondingly, the share that South Africa will receive from the customs pool will decline from 59.7% to 20.5% (based on 1996/97-2000/01 data) and the share from the excise pool will rise from 59.7% to about 81.7%. In combination, the gains and losses from the two pools are somewhat offsetting compared to the current formula. Using 1998/99 import and GDP data, Table 5.3 compares the revenue shares of the SACU countries under the current and new formulas assuming different shares

[77] Each of the five countries will get 20% of 15% of the excise pool. The 20% will be adjusted for deviations in the per capita income from the average of all SACU countries. A country with double the average per capita income will have its share reduced by 2 percentage points, while a country with half the average per capita income will have its share increased by 1 percentage point.

of SACU revenue coming from excises and customs duties. With an average of 55% of SACU revenues being collected from excise duties, compared to the average shares during 1996/97-2000/01, the share received by South Africa will fall by 5.6 percentage points with the BLNS countries sharing the corresponding gains. (The shares have to add up to 100%.) Given SACU revenues form a relatively small share of the South Africa budget (about 4 to 5%), this shift will not be disruptive in the short term. In the long term, however, the share of SACU revenues coming from excise duties can be expected to increase as incomes grow and trade liberalization reduces the importance of customs revenues.

Table 5.2 Estimated shares of SACU revenue pool under current and new formula

	Internal import share	GDP share	85% of excise share	GDP per capita	Development share	15% of excise share	Current shares of SACU pool
Country	1998/99	1998/99		1998/99			Average 96/97-00/01
				(Rand)			
Botswana	26.6%	3.5%	3.0%	17,968	18.7%	2.8%	12.7%
Lesotho	13.4%	0.6%	0.5%	2,395	21.5%	3.2%	7.4%
Namibia	24.9%	2.1%	1.8%	9,615	20.3%	3.0%	12.8%
Swaziland	14.6%	0.9%	0.8%	7,024	20.7%	3.1%	7.3%
South Africa	20.5%	92.8%	78.9%	17,587	18.8%	2.8%	59.7%
Average				10,916			

Table 5.3. Estimated changes in revenue shares of SACU revenue pool under new sharing formula and different shares of excise revenue in SACU pool

	Current shares of SACU pool	Combined new formula shares with 55% excise	Change in share (new minus current) with 55% excise	Combined new formula shares with 70% excise	Change in share (new minus current) with 70% excise	Change in total revenues under new formula and 70% excise
Country	Average 96/97-00/01	1998/99		1998/99		
Botswana	12.7%	15.2%	2.4%	12.0%	-0.7%	-0.7%
Lesotho	7.4%	8.1%	0.7%	6.6%	-0.7%	-4.9%
Namibia	12.8%	13.9%	1.1%	10.9%	-2.0%	-4.7%
Swaziland	7.3%	8.7%	1.4%	7.1%	-0.2%	-1.4%
South Africa	59.7%	54.2%	-5.6%	63.3%	3.6%	0.3%

If the share of excise duties increases, this will benefit South Africa significantly as it expects to get about 80% of its SACU revenues from the excise revenue pool. If the share of SACU revenues increases from 55% to 70%, for example, and weights from the import and GDP shares stay about the same as in 1998/99, then Table 5.3 shows that the share of the pool received by South Africa would increase by 3.6 percentage points rather than decrease by 5.6 percentage points. The BLNS countries would experience corresponding cuts in their total SACU revenue shares. As changes in the shares of the pool, these look modest, but as relative changes in SACU revenues they are large, particularly for Lesotho and Namibia. For Lesotho, which receives about 49% of its total revenues from SACU (see Table 5.1 above), this would represent a 5% cut in its total revenues. Namibia would experience similar relative losses in total revenues.

The new formula uses GDP of the member countries as a proxy of consumption to distribute the excise pool of revenues. For some countries GDP is not a good proxy for consumption as the Gross National Disposable Income (GNDI) that determines the consumption possibilities of the country differs markedly from the GDP because of significant Net Foreign Income and Net Transfers. Where GNDI is approximately equal to GDP, consumption typically falls in a range of about 60% to 80% of GDP. Lesotho is an extreme case, where GNDI exceeds GDP by about 50%, and hence, consumption actually exceeds GDP. For similar, but not so extreme reasons, consumption in Swaziland is about 95% of GDP. If consumption is used to share the excise pool rather than GDP, Table 5.4 shows that Lesotho and Swaziland would get increased shares, while Botswana would get a lower share and South Africa and Namibia would remain about unchanged. For Lesotho, it would increase its SACU revenues by about 1 to 2% of its total revenues.

Table 5.4. Impact of using consumption rather than GDP to divide SACU excise revenue pool

Country	Consumption share	GDP share	Difference in shares (consumption minus GDP)	Combined new formula shares with 70% excise based on consumption	Change in share (new minus current)	Change in total revenues under new formula and 70% excise
	Average 96/97-00/01	Average 96/97-00/01				
Botswana	2.7%	3.7%	-1.0%	11.5%	-1.2%	-1.2%
Lesotho	0.9%	0.6%	0.3%	6.8%	-0.5%	-3.5%
Namibia	2.4%	2.4%	0.0%	11.0%	-1.8%	-4.2%
Swaziland	1.1%	1.0%	0.2%	7.2%	-0.1%	-0.7%
South Africa	92.8%	92.3%	0.5%	63.3%	3.6%	0.3%

Overall, in the early years of introducing the new SACU revenue sharing formula, the BLNS countries are expected to gain in revenues, but with further reductions of the external SACU tariff over time, possible increases in excise yields as incomes rise, and/or excise rate increases, the BLNS countries could experience significant revenue losses compared to current SACU revenues. These revenue losses, largely from lower customs duties, would be accompanied by decreases in domestic prices that would open up opportunities to increase consumption taxes, such as the VAT, to replace these revenue losses.

5.2 Foreign aid dependence

A number of countries in SADC are receiving a high level of foreign aid. Table 5.5 gives the reported Official Development Assistance (ODA) as a share of the recipient country GDP between 19997-2001 from the Organization of Economic Co-operation and Development (OECD) Development Assistance Committee (DAC) countries.

Four countries have been in excess of 10%, namely: Zambia (31.6%), Malawi (27.0%), Mozambique (25.0%) and Tanzania (12.0%). Six countries received 2% or more of GDP as ODA during 1997-2001, namely: Angola, DRC, Lesotho, Namibia, Swaziland and Zimbabwe. This leaves only Botswana, Mauritius and South Africa receiving less than 2% in ODA. Actual grants reported in central government budgets during this period are lower. Three countries report more than 5% of GDP in grants: Zambia (6.2%), Malawi (6.0%) and Mozambique (10.3%), while a further seven report grants received of 1% or more. In addition, six countries report net foreign financing flows (mainly concessional loans from development agencies) in excess of 2% of GDP namely: Malawi (5.2%), Zambia (4.2%), Mozambique (3.9%), DRC (3.4%), and Lesotho (2.2%). [78]

While it is not expected that any significant aid cut backs will occur in the medium term, since the early 1990s aid flows in real terms have been declining and in the long-run countries are expected to grow and graduate out of aid dependency. High aid dependency also exposes countries to the risks of short-term disruptions in aid flows. Among the SADC Member States, the central government budgets of six countries show a combined grant and net foreign financing of over 3% of GDP, namely: Mozambique, Malawi, Zambia, DRC, Lesotho and Tanzania. Except for Lesotho, these aid flows form more than 25% of the total expenditures of the other five SADC countries. Hence, these countries face significant long-run challenges to increase their revenues or cut expenditures to replace these resource flows.

Conclusion

It is important to note that the order of magnitude of the fiscal challenge of replacing aid revenue is larger than that arising from the implementation of trade agreements and external trade liberalization. VAT as a broad-based consumption tax can play a role over the long run in reducing aid dependence.

[78] Official Development Assistance (ODA) includes grants (in cash and kind) and net concessional loan disbursements as reported by the donor countries. Actual grants and net foreign financing receipts reported in the central government budgets is typically less (sometimes by wide margins) than the ODA given a significant share of ODA may flow outside of the government budget and is not effectively captured by in the government accounts.

Table 5.5: Official Development Assistance, Grants, Deficits and Net Foreign Financing as Share of GDP, SADC Member States, Average 1997-2001

	Total Expenditure (including net lending)	Official Development Assistance	Grants	Overall Deficit	Net Foreign Financing	Grants and Net Foreign Financing as share of Total Expenditure
		Percentage of GDP				*Percentage*
Angola	46.0	4.5	2.4	(2.7)	(2.3)	0.1
Botswana	39.8	1.6	0.5	4.5	(2.8)	(5.7)
DRC	9.4	3.7	3.4	(6.4)	3.4	72.9
Lesotho (%GDP)	50.4	6.0	3.0	(3.0)	2.2	11.0
Lesotho (%GNDI)	35.0	4.2	2.1	(2.1)	1.5	
Malawi	27.9	27.0	6.0	(5.0)	5.2	40.2
Mauritius	23.3	0.8	2.9	(2.6)	(0.2)	11.7
Mozambique	26.0	25.0	10.3	(3.7)	3.9	54.6
Namibia	36.6	4.6	0.3	(3.5)	Na	na
South Africa	29.5	0.4	0.1	(3.3)	0.8	3.2
Swaziland	29.6	2.0	0.7	(0.2)	0.4	3.7
Tanzania	16.9	12.0	3.8	(1.0)	0.7	26.6
Zambia	29.2	31.6	6.2	(4.1)	4.2	35.8
Zimbabwe	41.5	3.4	1.0	(10.2)	(0.7)	0.8

5.3 Government expenditures and overall deficits and macroeconomic convergence in SADC

Closely related to the fiscal issue of aid dependence, is the issue of the fiscal demands of high total expenditures of most of the central governments of SADC Member States along with high overall budget deficits. Table 5.5 shows that except for DRC and Tanzania, the total expenditures exceed 20% of GDP during 1997-2001. In two cases, Angola and Zimbabwe, it is over 40%. In three cases, Botswana, Lesotho,[79] and Namibia it is over 30%. In the remaining six countries, five are over 25% and only Mauritius is over 20%, but under 25%. At the same time, seven of the SADC countries maintained average deficit levels during 1997-2001 of over 3% of GDP, and except for South Africa, Namibia and Zimbabwe, these deficits were largely being covered by net foreign financing. Under the SADC Memorandum of Understanding on Macroeconomic Convergence (that similar to the SADC Tax MOU was signed in 2002, and also will be subsumed into the SADC Finance and Investment Protocol) member countries will in the long run have to maintain inflation and deficit to GDP ratios at or below about 3%. In addition, stocks of public and publicly guaranteed debt will have to be kept below 60% of GDP. A combination of revenue and expenditure measures, including indirect taxes on consumption such as VAT will need to be used achieve these macroeconomic targets

[79] In the case of Namibia, Gross National Disposable Income exceeds GDP by 44% over 1997-2001. Hence, it is more reasonable to report the size of government relative to the total expenditure possibilities of Lesotho at 33.3% of GNDI rather than 47.9% of GDP.

Large size governments need to be financed and this creates a revenue problem. This can be solved either by reducing the size of government or by raising additional tax revenues, for example through consumption taxes such as VAT or by other means. Table 5.7 shows some international comparisons of total expenditures and revenues (non-tax plus tax revenues) for different income and regional groupings of countries over 1997-99. As shown in Table 2.1 above, SADC countries, except for Botswana and Mauritius, are low and lower middle-income countries. Table 5.7 shows internationally that, while expenditures and revenues as share of GDP tend to rise with income level on average, central government expenditures and revenues fall below 20% of GDP. This contrasts expenditures with 10 out of the 13 SADC countries falling above 25% of GDP. Table 5.7 also shows that governments in Sub-Saharan African countries (which are mainly low and lower middle-income countries) have expenditures and revenues in excess of 20% of GDP. SADC countries have similar, but somewhat larger governments than the Sub-Saharan average. This contrasts with the countries in East Asia and the Pacific Region where government expenditures and revenues tend to fall below 20% of GDP. At the same time, it is recognized that many of the countries that have sustained high growth rates in recent decades are in this region. This suggests that consideration needs to be given to solving the fiscal demand challenges of loss of customs duties, reduction in aid and deficit control, at least in part, through *reducing government expenditures as opposed to raising government revenues.*

Table 5.7. Total Expenditures and Tax and Non-Tax Revenue by Income Group and Region, 1997-99

Country Group	Total expenditure (excluding net lending)	Tax and Non-tax Revenue
	Percentage of GDP	
Low income	17.7	14.7
Lower middle income	19.6	15.8
Upper middle income	23.9	22.3
Sub-Saharan Africa	26.1	23.3
East Asia & Pacific	13.7	10.8

World Bank Development Indicators 2003

Table 5.7 also illustrates a basic issue that needs further detailed analysis. Government revenue tends to increase as per capita income levels rise in a country. It is recognized that the capacity to raise revenues in low-income countries is limited by many structural factors such as large informal or non-monetary productive sectors. As economies grow and develop, these structural constraints decline and the ability to collect revenues efficiently and effectively increases. To some extent, countries can be expected to "grow out" of their revenue problems as the structural constraints on revenue capacity are relaxed with growth and economic development. This change in the structural features of an economy will also impact the effectiveness of the implementation of a VAT system. Accordingly, the next Chapter analyzes the issues relating to tax capacity and effort across the SADC Member States.

VI. Tax capacity and efficiency

6.1 Introduction

The size of government (or total government expenditures as a share of the economy) is a matter of public choice, but this choice is constrained by the characteristics of an economy that affect the feasibility and costs of raising revenues to finance government operations. Certain features of an economy make for more or less cost-effective revenue raising efforts.

Features that lower the administrative and compliance costs of revenue collection are typically referred to as "tax handles." Good tax handles include imports forming a high of the economy, most imports entering through well-controlled sea, air or rail ports, large formal sector mining operations and a large share of business activities being conducted in large formal sector corporations.

By contrast, other features of an economy can make for difficult tax collections. These include a large non-monetary or subsidence agriculture sector, a large informal or micro-business sector with poor books and records, a weak accounting profession, and low levels of literacy and numeracy which undermine the ability of the private sector to self-assess taxes such as income tax or VAT.

These types of structural characteristic affect the "tax capacity" of a country or the feasibility of a country to administer different types of tax.

This Chapter first sets out to explore the nature of the tax capacity and how this is evidenced in the actual tax performance of SADC Member States. The role of various structural features of the SADC countries in explaining differences in tax yields will also be analyzed. This understanding helps with the understanding of the limits on the ability of a country to solve its public finance problems through higher tax yields such as from VAT and other taxes over the near and medium terms. It also helps to explain differences in tax efficiency of the VAT and sales taxes across SADC Member States. Tax efficiency is a measure of the effective tax base relative to estimates of the maximum tax base. The constraints on the effective tax base will then be used to discuss the effects of limits on the relative size of the tax base on the price responsiveness of that tax base to increases in the VAT rate.

6.2 Tax capacity

Introduction

The impact of the structural tax capacity features of a country shows up strongly when the level and composition of central government revenues is compared across different groupings of countries at different per capita income levels. Table 6.1 gives the level and composition of central government revenues from the World Bank World Development Indicators (WDI) for 1997 or 1998 for groupings of countries

according to per capita income.[80] These results show that overall central current revenues rise from the low-income group at 13.4% of GDP to the high-income group at 28.4% of GDP (and 36.9% of GDP among the European Monetary Union countries) in 1997-98. Tax on international trade at 25.8% of current revenues is important among low-income countries, but is negligibly small among high-income countries. Taxes on goods and services are important among country groupings. Taxes on income, and especially social security taxes (which are generally payroll or employment taxes), however, rise sharply from the low-income countries to the high-income countries. Combined income and social security taxes form only about 20% of current revenues among low-income countries to nearly 50% among high-income countries and about 64% among the European Monetary Union countries.

Table 6.1. Level and composition of central government revenues by country groups, 1997-8

					Shares of current revenue						
Country Group	Year		Current revenue as share of GDP	Tax revenue as share of GDP	Tax revenue	Taxes on trade	Taxes on goods and services	Taxes on income, profits, etc	Social security taxes	Other taxes	Non-tax revenue
			Percentages								
Low income	1998	As reported	13.4	11.0	82.2	20.9	27.9	16.2	0.0	1.5	13.2
Lower middle income	1998	As reported	18.5	16.0	86.6	9.7	36.6	19.5	4.0	2.6	13.6
Low income	1998	Adjusted	13.4	11.0	82.2	25.8	34.5	20.1	0.0	1.9	17.8
Lower middle income	1998	Adjusted	18.5	16.0	86.6	11.6	43.7	23.3	4.7	3.2	13.4
Upper middle income	1997	As reported	19.9	17.7	88.9	4.3	39.5	16.2	28.2	3.6	10.5
High income	1997	As reported	28.4	25.9	91.2	0.04	27.3	28.6	19.7	15.5	8.6
High income OECD	1997	As reported	28.4	26.0	91.6	0.003	26.6	29.8	25.0	10.2	7.3
European Monetary Union	1997	As reported	36.9	33.6	91.1	0.0	26.0	29.7	33.4	2.0	6.4

World Development Indicators 2004; author calculations

Table 6.2 shows the pattern of levels and sources of revenues of all levels of government for Organization of Economic Co-operation and Development (OECD) countries over time from 1870 through 1995. These patterns of change are very similar to those observed across countries of different income levels in Table 6.1. Revenues rise from about 10% of GDP (even lower than amongst current low-income countries) in 1870 to about 43% of GDP in 1995. The share of revenues from

[80] Note that the shares of current revenue for different groupings of countries as reported in the WDI database do not necessarily add up to 100 per cent, particularly in the low income and lower middle income groups because of missing data and weighting problems in aggregating the data. As a result, adjustments have been made to the shares of revenue by source to scale them such that they add up to one hundred percent.

international trade falls from about 17% of total government revenues (the share of central government revenues would have been higher) to negligible levels in 1995. Indirect taxes on goods and services remain important over the whole period. Direct income taxes, including social security contributions rise dramatically over time, particularly after World War II, from 2.4% of GDP or 22.6% of revenues to 26.1% of GDP or 60.2% of revenues in 1995.

Table 6.2. All Levels of Government Revenues as a Share of GDP in OECD Countries, 1870-1995

Percentages

	Share of revenues in 1870	About 1870	1913	WWI	1920	1937	WWII	1960	1980	About 1995	Share of revenues in 1995
Indirect taxes, customs	17.0	1.8	1.7		1.6	2.2				0.5	1.2
Indirect taxes, domestic	28.3	3.0	3.0		3.4	4.9		11.6	11.8	13.5	31.1
Direct taxes	22.6	2.4	2.6		3.2	3.4		9.5	13.5	14.0	32.3
Social security contributions								7.1	10.5	12.1	27.9
Other receipts	32.1	3.4						3.4	3.6	3.3	7.6
Total revenues	**100.0**	**10.6**	**11.8**		**19.2**	**21.6**		**28.7**	**40.1**	**43.4**	**100.0**

Vito Tanzi and Ludger Schukenecht, *Public Spending in the 20th Century*

Items do not always add to total in year due to missing values for member countries in some years

These patterns reflect the need for low-income countries to rely on tax handles such as border collections on trade as well as the difficulties of collecting direct taxes that require both formal business accounting practices and income levels of individuals to be high enough above some minimum threshold to be subject to tax. Low-income countries are often characterized by factors that make the collection of tax infeasible, expensive and/or unproductive. These include:

(i) significant non-monetary sectors (or subsistence agricultural sectors);
(ii) a large share of the economic activity in the agricultural sector resulting in widely dispersed business activity with much of it conducted by small scale farmers with poor books and records;
(iii) large numbers of informal businesses in small scale agriculture, manufacturing, trade and services that mainly operate without books and records;
(iv) large unskilled labor force with wages levels that are largely income-tax exempt or only in falling in the lowest tax brackets;
(v) weak accounting standards and relative few professional accountants to maintain books and records for tax purposes; and

(vi) low educational attainment or relatively high illiteracy rates that make compliance with self-assessed taxes such as the income tax or VAT difficult.

Even in a low-income country, however, there may be some tax handles that raise its revenue raising potential such as a relatively large volume of imports flowing through a well-managed port, or large mining operations of multinational corporations that are make significant profits and exporting most of their product. As per capita incomes grow in most economies, however, many of the adverse factors on tax administration and compliance decline and at the same time the share of workers with higher and taxable incomes grows. Growth in per capita income and income taxes on this income has proved to be the major source of revenue across countries.

While central government tax revenues from indirect consumption taxes grow around 4% of GDP to a range of 9% to12% of GDP moving from low to high-income countries in Table 6.1, tax revenues from the income taxes (including social security taxes) rise rapidly across the income levels of countries: low, 3%; lower middle, 5%; upper middle, 9%, and high, 14% of GDP. Amongst the high-income countries, income and social security taxes are 16% of GDP for OECD countries, and 23% of GDP for the European Monetary Union Countries. At all levels of government, OECD countries averaged some 26% of GDP in direct income and social security taxes in 1995.

Structural features constrain the ability of low income countries to collect taxes on income, but as income levels grow and the middle class becomes a high share of the economy in the middle income countries, income taxes, particularly payroll taxes, become more feasible for more persons and the base grows rapidly as individuals both become taxable and also move up into higher tax brackets. At higher income levels, the issue becomes one of choice of the size and role of government rather than the constraints on revenue collections in a country deciding on a target yield for taxes. In addition, once top tax rates have been set, tax revenues as a share of the economy are limited by these rate choices and will approach maximum shares as the efficiency of any tax rises (or the share of the economy subject to these maximum rates approaches its maximum potential.)

As shown in Table 2.1 above, SADC Member States range from low to upper middle-income countries. The issues of the importance of structural features of the economy limiting the tax yield are still important, but greater degrees of freedom in taxation exist for the upper middle-income countries.

Explanation of economic analysis

To analyze the importance of structural features in limiting tax yields (tax revenues as a share of GDP) across countries, comparisons of the tax yield across SADC Member States will be made taking into account the effects of a number of structural characteristics such as per capital income, the importance of imports, the relative size of the agricultural sector and the level of literacy of the adult population. These comparisons will be achieved using standard economic regression techniques, but this

analysis will introduce a number of innovations not included in previous studies, [81] to account for the changes in incentives to governments to collect taxes when other sources of revenue such as foreign aid grants or non-tax revenues are available and the external imbalances of the economy that affect the size of consumption tax bases, such as net inflows of foreign factor income or transfers.

The basic model that will be estimated is

$$T/Y = \alpha + \beta_1 \ln Y_{pc} + \beta_2 (Y_{pc})^2 + \beta_3 X_3 + \ldots.. + \beta_i X_i + \beta_{i+1} Z_{i+1} + \ldots.. + \beta_j Z_j + \beta_k T + \varepsilon$$

The elements of this model are explained in more detail below. In general:

- T/Y is the tax yield (or tax effort) that make up the tax revenues of a central government as share of GDP,
- Y_{pc} is the per capita income of each country expressed in a quadratic of the natural logarithm of per capita income to allow for the changing impact of per capita income at different income levels,
- X_i are the structural features of the economy that affect the capacity to raise tax revenues,
- Z_j are the characteristics of other revenue sources affect the incentives to collect taxes, and
- T is time, which is included to capture the net affect of all omitted variables that have a systematic affect on the tax yield over time, and ε is random normal variable that captures the unexplained variations in the tax yield.

This linear specification is the usual specification used and is appropriate as it allows for the independent effects of different structural features. A relationship of the logarithm of tax effort explained by the logarithm of the structural variable assumes that they have multiplicative effects on the tax yield such that improvements in any one structural feature has a larger impact the more favorable are all other structural features. (See Piancastelli (2001), Ebrill *et al* (2001), and Katusiime (2003))[82].

While some synergies no doubt exist, it is not necessarily true in all and certainly not in many important cases. For example, large mining sectors or large share of imports in countries with otherwise unfavorable tax collection characteristics under a multiplicative model would make relatively low impacts on revenue collection performance, but in countries with good revenue collection characteristics they would make large impacts on its revenue yield. While to some extent this may be the case,

[81] A.R.Prest " The Taxable Capacity of a Country" in Toye J.F. (ed), Taxation and Economic Development, London,1979; Richard Goode, *Government Finance in Developing Countries*, Brookings Institution, Washington DC (1984), Chap 4.

[82] Piancastelli only presents estimates of tax yield as log-log specification, while Katusiime presents the log-log as an alternative specification. Ebrill et al explain the log $(\theta/(1-\theta)$, where θ is a measure of the revenue ratio, in terms of the logs of explanatory variables.
Marcelo Piancastelli, Measuring the Tax Effort of Developed and Developing Countries, Cross Country Panel Data Analysis –1985/95, IPEA, Rio Janeiro, Brazil, 2001
Liam Ebrill, Michael Keen, Jean Paul Bodin and Victoria Summers, *The Modern VAT*, International Monetary Fund (2001)
Frank M. Katusiime, "Measuring Tax Performance among Esat African Countries'" URA Fiscal Bulletin, Vol 2 (no 1) June 2003, pp 1-50

an economy with generally poor revenue capacity is likely to focus its limited revenue collection resources on the mining sector or import flows, whereas a higher capacity economy may put a more modest effort into collecting from the mining sector or imports given its range of alternative sources. Good tax handles can clearly benefit low-income countries despite otherwise unfavorable tax collection characteristics.

The range of structural features that can be used to explain the tax yield in a country is limited by the availability of data across countries. For example, data on the number and quality of accountants is not generally available across countries. Typically, the value added in the agricultural sector as a share of the economy is used to capture the importance of the unfavorable characteristics of this sector on tax collections. The structure of agricultural sectors across countries, however, may vary in ways that impact tax collections. For example, an agricultural sector dominated by large corporate farms producing cash crops is different, tax-wise, from one dominated by small farmers producing food crops. These limitations in the data have to be recognized in making cross-country comparisons.

Annual data is used in this analysis that covers the fiscal years of SADC Member States ending in 1990 through to 2001 and is drawn from the best available data on the fiscal operations and national economy. The fiscal operations data is typically drawn from the IMF Government Financial Statistics and the country reports of the IMF published on the internet from time to time.

In a few cases, gaps in data were filled directly from country data where these were available. In calculating ratios of taxes or other variables to GDP care was taken to ensure that the GDP was adjusted to cover the same time period as the taxes or other revenues. It is noted that a number of studies that rely on the World Bank data in the World Development Indicators (WDI) data sets have systematic biases affecting cross-country comparisons. For example, a country with a fiscal year end of June 30 such as Tanzania, and national accounts reported for a calendar year, WDI will report the tax yield for the fiscal year end using the GDP measure for the prior year giving an upward bias to the yield compared to a country that has its fiscal and national accounts covering the same period (such as both reported for the calendar year as for Zambia.) Socio-economic data are generally captured from the WDI database or the United Nations statistics. The average values and available observations for the key variables of the revenue yield and economic structure for the SADC Member States are shown in Table 6.3 below.

Non-monetary, informal sectors and agricultural sectors

One feature of an economy that affects the potential tax yield is the size of the non-monetary sector. This is typically characterized by subsistence agriculture and self-supplied housing. In economies such as Malawi and Tanzania, these are estimated to be significant shares of GDP, and hence, raise issues of comparability of tax capacity across countries. Malawi national accounts report the self-consumed production of smallholder farmers as an estimate of the non-monetary sector valued in GDP. Between 1994-2003, the non-monetary sector in Malawi is reported by the National Statistical Office to have grown from 18.5% to 27.4% of GDP as the relative size of the smallholder-farming sector has grown. National accounts reported by the Central

Table 6.3. Average values of tax yield and other explanatory variables for SADC Member States for 1990-2001

(Percentages unless otherwise specified)

	Angola	Botswana	DRC	Lesotho	Malawi	Mauritius	Mozambique	Namibia	South Africa	Swaziland	Tanzania	Zambia	Zimbabwe
Per capita income (Ypc) (1995 constant US$)	$ 492	$ 3,161	$ 135	$ 505	$ 155	$ 3,461	$ 169	$ 2,156	$ 3,952	$ 1,368	$ 183	$ 418	$ 639
Tax revenues over GDP (T/Y)	37.8	21.6	3.5	35.6	15.4	18.5	11.0	28.8	23.6	26.8	11.1	18.2	24.5
Non-tax revenue over GDP (NT/Y)	0.4	22.8	0.6	7.4	1.5	2.6	1.0	3.5	1.6	1.9	3.1	0.8	2.4
Total Revenue over GDP (TR/Y)	38.2	44.3	4.1	42.9	14.2	21.1	12.0	32.4	25.2	28.7	14.2	19.0	26.8
Grants over GDP (G/Y)	2.3	1.0	2.2	5.4	6.0	0.2	10.4	0.9	0.2	0.8	2.8	8.4	1.3
Net Factor Receipts plus Net Transfers over GDPO ((NTr+NFR)/Y)	(9.5)	2.0	(7.5)	81.5	0.9	2.4	6.3	14.8	(4.5)	12.2	5.9	(2.7)	(2.0)
Gross National Disposable Income (GNDI/Y)	90.5	102.0	92.5	181.5	100.9	102.4	106.3	114.8	95.5	112.2	105.9	97.3	98.0
Tax revenue over GNDI (T/GNDI)	42.5	21.1	3.8	19.9	15.3	18.1	10.4	25.1	24.7	23.9	10.5	19.0	25.0
Agriculture sector value added over GDP (Ag/Y)	8.8	4.3	48.8	15.9	33.6	9.2	28.4	10.2	3.7	11.6	42.8	18.9	9.4
Mining sector value added over GDP (Min/Y)	54.4	37.4	9.0	0.1	0.3	0.1	0.3	11.6	6.7	6.2	0.8	8.5	2.9
Manufacturing sector value added over GDP (Manuf/Y)	20.6	4.8	6.3	7.4	14.4	20.6	9.7	11.4	19.0	26.6	7.2	17.4	20.7
Imports over GDP (M/Y)	53.7	43.7	18.8	102.2	33.2	55.2	31.5	44.0	19.1	76.6	24.7	24.1	51.8
Exports of gods and services over GDP (X(G&S)/Y)	72.6	50.5	23.6	22.9	26.9	62.4	16.7	49.6	24.6	57.8	18.1	34.5	32.1
Money supply (M2) over GDP (M2/Y)	17.6	17.7	13.4	33.5	19.1	75.5	26.4	33.3	53.1	35.7	21.1	18.8	72.1
Adult illiteracy rate	n.a.	29.6	44.8	19.5	44.5	17.6	59.3	21.2	16.5	21.4	30.4	26.3	14.9
Fiscal years with T/Y data	1992-2001	1990-97	1990-2001	1990-2001	1990-2001	1990-2001	1993-2001	1990-2001	1990-2001	1990, 1993-2001	1990-2001	1990-2001	1990-2001
Observations with T/Y	10	8	12	12	12	12	9	12	12	10	12	12	12
Fiscal years with T/Y data and adult illiteracy		1990-97	1996-2001	1990-2001	1994-2001	1990-2001	1993-2001	1990-2001	1990-2001	1990, 1993-2001	1990-2001	1990-1, 1996-2001	1990-1999
Observations with T/Y and all explanatory variables	-	8	6	12	8	12	9	12	12	10	12	7	10

Bank of Tanzania show the non-monetary agricultural sector at 30% of GDP at factor costs in 1986, then falling to 26.1% in 1990 and rising again to 29.9% by 1999.

While all the economies of SADC country members contain some share of non-monetary production and consumption, even if small in the case of the middle-income countries, unfortunately the member countries outside of Malawi and Tanzania do not report the non-monetary share of GDP. Ideally, a measure of the size of the non-monetary sector included in the GDP in each country would be an important variable to explain tax capacity. Here it is assumed that all countries are providing estimates of GDP inclusive of the non-monetary sector even if they are not explicitly measured. Given that the bulk of the non-monetary sector is in the agricultural sector, the agricultural sector value added as a share of GDP (Ag/Y) becomes an important variable to capture the impact of the non-monetary sector.

A high agricultural sector share is also expected to indicate the presence of a high concentration of informal farmers on smallholdings as well as indicate relatively high costs of tax administration and compliance. The agricultural sector share is expected to be strongly but negatively related to the tax yield across countries. In fact, it shows up as the single most important variable, and taken alone, it explains 50% of the variance in the tax yield across countries. The impact of an increase of one percentage point in the agricultural sector share when taken alone is –0.47, but this effect moderates to –0.3 when in a more complete specification (see Table 6.4). The agricultural sector ranges from about 4% of GDP in Botswana and South Africa up to 34% in Malawi, 43% in Tanzania and 49% in DRC. A range of 45% of GDP in the share of agricultural value added explains a variation of 13.5 percentage points of GDP in tax yield.[83] Other comparable studies also find significant negative impact of the agricultural sector share on tax yields: Katusiime (2003) estimated a coefficient of –0. 2 for East African countries over 1991-98 and Stotsky et al (1997)[84] estimated –0.17 for Sub-Saharan African countries over 1990-95.

Mining sector and trade

The mining sector is a standard target for government revenues given that it is generally concentrated in terms of location and corporate ownership and has a measured output that is typically exported. The mining sector is important in many SADC Member States and plays a dominant role in a few, such as Angola and Botswana. Estimates in Table 6.4, show a one-percentage point increase in the share of the mining sector adding 0.2 to 0.3 percentage points out of GDP to the tax revenues. As will be noted below, the mining sector can also be a significant source of non-tax revenues, which is expected to reduce the pressure on governments to raise its tax effort.

[83] Another approach to estimating the impact of the non-monetary and informal sectors is to uses measures of the depth of the financial sector. For example, the higher the ratio of the broad money supply (say, M2 over GDP or M2/Y), the smaller is the expected the role of the non-monetary and informal sectors in the economy. M2/Y is expected to be positively related to T/Y. In fact, when T/Y is regressed on M2/Y alone, a small but statistically significant coefficient of 0.072 is found. The explanatory power of M2 disappears, however, when over economic structural variables are included.

[84] Janet G. Stotsky and Asegedech WoldeMariam, "Tax Effort in Sub-Saharan Africa" IMF Working Paper (WP/97/107) September 1997

Not all other studies of tax capacity have included the effects of the mining sector, particularly more recent studies. Earlier studies by Chelliah (1971), Chelliah et al (1975) and Tait et al (1979)[85] based on data for the late 1960s and early 1970s, however, found strong impacts of mining sector share in GDP with coefficients in the range of 0.36 to 0.57. Similar results are obtained if oil and other mineral export values as a share of GDP are used as explanatory variables. In these studies, other exports have the mineral exports removed. This study shows the mining sector being somewhat less important in explaining tax yields across countries in the 1990s. In Stotsky et al (1997), the effect of the mining sector for Sub-Saharan African countries is surprisingly negative at –0.26, but the export share is positive in the range of 0.25 to 0.34, offsetting the negative mining sector coefficient. In this SADC study, interestingly, exports as a share of GDP is either not significant or has an unexpectedly negative sign, and when the export share is included the coefficient on the mining sector share increases to offset the negative effect of exports. It is important to recognize that in most countries exports are not taxed directly. Hence, when exports are included they act as a proxy for indicating the relative size of the formal sector, which typically produces and/or manages most export trade.

Imports

As emphasized elsewhere in this study, imports form an important tax handle for both import duties and for capturing the import component of consumption taxes such as sales tax, VAT and excise duties. A higher share of imports in GDP offers the opportunity for improved taxation efficiency, if not higher final taxes. In addition, in countries with large informal sectors, taxation of imports that are inputs into informal sector production or trade, allows taxes to be collected on the inputs into informal sector production and trade, if not the final sales. If the import share in GDP is used as the only explanatory variable, it has a coefficient of 0.26 and explains some 44% of the variance in tax yields. When a more complete set of explanatory variables are included, Table 6.4 shows that the share of imports is still significant, but the coefficient is much smaller in the range of 0.02 to 0.07.[86] These results are similar to those for Sub-Saharan Africa reported by Stotksy et al (1997), but lower that the 0.126 found by Katusiime (2003) for East African countries.

Gross National Disposable Income.

GDP is a good measure for estimating the potential of taxes based on domestic value added or production, but it can be misleading for estimating potential consumption where a country has significant net transfers and net factor receipts (NT+NFR) from the rest of the world. These can either raise or lower the consumption potential of a country relative to GDP. As mentioned above and will be discussed in more detail below, consumption in some countries (Lesotho being an outstanding example) can

[85] R.J. Chellliah, Trends in taxation in Developing Countries, IMF Staff Papers, No 18, 1971
R.J. Chellliah, H.J. Baas and M.R. Kelly, Tax ratios and tax effort in developing countries, 1969-71, IMF Staff Papers, No 22, 1975
A. Tait, W.L.M. Gratz, B.J. Eichengreen, International Comparisons of Taxation for Selected Developing Countries, 1972-76, IMF Staff Papers, No 26, 1979

[86] The apparent strong effect of the share of imports as a single explanatory variable arises because its strong correlations with a number of the other omitted explanatory variables such as the share of agriculture (negative correlation) and share of net foreign transfers and factor income (positive correlation) biases its value upwards. When these explanatory variables are included, the coefficient on the share of imports declines.

exceed GDP. Hence, net transfers (NT) plus net factor receipts (NFR) over GDP is included to adjust for the potential differences in revenue potential. In fact, Table 6.4, shows that tax yields increase by about 0.19 percentage points of GDP per one-percentage point increase in NT plus NFR over GDP. This impact is not taken into account in other studies.

Table 6.4. Estimates of tax yield as function of economic structural variables, alternative revenue sources and per capita income for SADC Member States, 1990-2001

Explanatory variables	Coefficient	t-stat.	Coefficient	t-stat.	Coefficient	t-stat.	Coefficient	t-stat
Constant	-549.77	*-2.65*	-250.92	*-1.25*	-634.27	*-3.34*	-461.54	*-2.47*
Agriculture sector value added over GDP (Ag/Y)	-0.31	*-10.39*	-0.27	*-8.55*	-0.30	*-4.58*	-0.28	*-4.54*
Mining sector value added over GDP (Min/Y)	0.32	*11.56*	0.19	*2.96*	0.28	*10.83*	0.17	*2.89*
Imports over GDP (M/Y)	0.07	*3.08*	0.05	*2.46*	0.02	*0.70*	0.001	*0.05*
Net Factor Receipts plus Net Transfers over GDP ((NTr+NFR)/Y)	0.19	*8.14*	0.17	*7.55*	0.19	*9.27*	0.19	*9.28*
Grants over GDP (G/Y)	-0.41	*-3.66*	-0.19	*-1.33*	-0.54	*-3.99*	-0.49	*-3.34*
Non-tax revenue over GDP (NT/Y)	-0.55	*-7.71*	-0.32	*-3.16*	-0.44	*-6.73*	-0.29	*-3.10*
Adult illiteracy rate			-0.11	*-2.50*			-0.02	*-0.38*
Ln(Per capita income) (Ln(Ypc)) (1995 constant US$)					25.54	*4.13*	25.74	*3.90*
Ln(Per capita income) squared ($Ln(Ypc)^2$) (1995 constant US$)					-1.96	*-4.56*	-1.96	*-4.29*
Year	0.29	*2.76*	0.14	*1.37*	0.29	*3.13*	0.20	*2.25*
Adjusted R-squared	84.8%		84.5%		88.2%		87.9%	
F-statistic	98.7		80.5		102.8		86.2	
Observations	124		118		124		118	

Table 6.5. Estimates of tax yield as a non-linear function of per capita income for SADC Member States, 1990-2001

Explanatory variables	Coefficient	t-statistic		Coefficient	t-statistic
Constant	-1.962	*-1.00*	Constant	-228.12	*-11.79*
$Y_{pc} \leq 375$: $Y_1 = Y_{pc,}$ otherwise 375	0.077	*8.98*	$\ln(Y_{pc})$	74.59	*12.35*
$375 < Y_{pc} \leq 750$: $Y_2 = Y_{pc} - 375$, otherwise 375	0.011	*1.10*	$\ln^2(Y_{pc})$	-5.39	*-11.76*
$750 < Y_{pc} \leq 1500$: $Y_3 = Y_{pc} - 750$, otherwise 1500	-0.004	*-1.00*			
$Y_{pc} > 1500$: $Y_4 = Y_{pc} - 1500$	-0.003	*-3.26*			
Adjusted R-squared	61.1%			59.5%	
F-statistic	57.5			106.8	
Observations	145			145	

Grants and non-tax revenue

When the determinants of tax revenue are being estimated, it is important to recognize that where a government has other sources of revenue, the tax effort can be expected to decline to the extent these substitute for tax revenue. A number of countries in SADC either received significant grants through foreign aid (such as Lesotho, Malawi, Mozambique and Tanzania) and/or have significant non-tax sources of revenue (such as Botswana and Lesotho). Table 6.4 shows that increases in grant revenues reduces taxes by about 19% to 54% of the amount received as governments partially substitute grants for tax effort. It is recognized that foreign aid is also received in the form of concessional loans with a large grant component to the loan. If the net flows of foreign financing are added to grants the coefficient drops to about 0.22, but the data on foreign loans do not distinguish between the concessional and commercial components of the foreign loans.

Non-tax revenues, particularly where these are not user charges covering incremental expenditures, can also depress the tax effort of a country. Table 6.4 shows non-tax revenues reducing tax revenues by 29% to 55% of the revenues received. Katusiime (2003) recognizes the effect of non-tax revenue in the study of East African countries and finds that it reduces tax revenues by 32%. Other studies to recognize the problem caused by grants and non-tax revenues include Embrill et al (2001) where total revenues from taxes, non-taxes and grants become the determinant variable, but this estimate of the aggregate excludes the possibility of estimating the degree of substitution between types of revenue.

Time

Given the data used are annual data for 1990 through to 2001, the variable of the fiscal year of the data is included to pick up any trends resulting from trends in the effect of the explanatory variables not included in the study. Table 6.4, shows a significant positive effect of between 0.14 and 0.29 percentage point increase in tax yield per year.

Adult illiteracy rate

Education, especially a basic level of literacy, is critical to the compliance and administration of taxes, especially self-assessed taxes such as income tax and VAT. It is, therefore, expected that that high adult illiteracy rates will lead to lower tax yields. Table 6.3 shows, illiteracy rates across SADC Member States during the 1990s averaging from a low of 14.9% in Zimbabwe to a high of 59.3% in Mozambique. (No data was available for Angola for this period.) Education, however, is also an important and strong explanatory variable of per capita levels.[87] When used as an explanatory variable on its own, it has a large and significant coefficient of –0.457 and explains 46% of the variance in tax yields. When other structural explanatory variables are included the coefficient drops to –0.11, and when per capita income is also included its impact becomes insignificant.

[87] An estimate of per capita income (constant 1995 US dollars) across the SADC countries in terms of adult illiteracy gives the following result: Per capita income = $3,048 - $58*(adult illiteracy rate, in percentage points) with a t-statistic of –7.2 for the coefficient of adult illiteracy and 27% of the variance explained. This implies that a country with 50% illiteracy would have a reduction in per capita income of $2,900 compared to one with 100% literacy, or a per capita income of $148 compared to $3,048 at 0% illiteracy.

Per capita income

As discussed at the beginning of this Chapter, growth in per capita income in a country is expected to a have a significant effect on tax yields, particularly through the taxation of income and payrolls and particularly as the share of middle-income earners in an economy increases. It is important to recognize, however, as just discussed for the adult illiteracy rate, per capita income is highly correlated with a number of the economic structural variables that have just been discussed as being important for tax yields. For example, as economies grow the share of the agricultural sector and imports as a share of GDP tend to decline. Foreign aid grants also decline with rising per capita GDP. Aside from the interaction with adult illiteracy rate just described, Table 6.4 also shows the coefficient on the import share declines when the income level is included.

Typically, only the level of per capita income has been used an explanatory variable in previous studies of tax capacity. As tax history, cross-country experience and economic logic argue, however, the impact of rising per capita income is expected to be non-linear. Tax yields are expected to grow very rapidly as the formal sectors and middle class grow with growing per capita income levels. This growth is expected to slow down as the share of middle-income earners increases. In addition, once the structural constraints on tax collections become weaker and the capacities of private sector partners to deliver public services become stronger, governments have more latitude to choose the size of government. It is possible that the size of government will not necessarily continue to increase with a growth in the size of the economy. At a minimum, with a constant set of *ad valorem* (by value) tax rates covering a broad base of the economy, the tax yield is expected to flatten out as it approaches a theoretical limit set by the highest *ad valorem* rates and any ceilings on taxable income as are often imposed on social security contributions.

Two specifications are used to illustrate the non-linear relationship between tax yield and per capita income in Table 6.5. The first is to use a "piece-wise linear specification" and the second is a quadratic of the logarithm of per capita income. The piece-wise linear approach breaks down the relationship into different line segments over different ranges of per capita income. Here the effect of income over the first $375 bracket, the next $375 bracket up to $750, the next $750 up $1,500, and then all per capita income over $1,500. This specification shows a strong positive relationship over the first $375 of per capita income, a weak positive relationship over the next $375, and then weak negative relationships over the next brackets of income.

Overall this implies, tax yields rising to 27% by $375 of per capita income, and 31% by $750 and then falling to 28% by $1,500 and 23.6% by $3,000. The quadratic specification in logs gives $74.59\log(Y_{pc}) - 5.39\log^2(Y_{pc})$, which implies a similar pattern of strongly rising tax yield in the low per capita income range, but slowing down to reach a maximum tax yield at $1,018 and then gradually falling.[88]

[88] For the relationship $y = \alpha + \beta_1 \log x + \beta_2 \log^2 x$, with $\beta_1 > 0$ and $\beta_2 < 0$, y reaches a maximum at $x = \exp(-\beta_1/2\beta_2)$

Given both specifications explain about 60% of the variance in the tax yield, but the quadratic log specification uses less degrees of freedom, it is used in the full specifications shown in Table 6.4. When per capita income is included with the other economic structural features of the SADC Member States, the implied maximum impact of per capita income occurs at $670. Adding per capita income to the specification raises the share of the variance in the tax yield explained from 84.8% to 88.2%.

Summary

The analysis presented above confirms the diversity of the economies within the SADC region and the systematic impact of many of their economic features on their capacity to collect tax revenues. Many of the structural features that have negative impacts on tax collection capacity, particularly large non-monetary, informal and agricultural sectors, will not be overcome in the short or even medium terms. Some countries have tax capacity features such as large corporate mining sectors or large volumes of imports amenable to customs control which can be exploited in the medium term. In addition, any country can enhance its administrative efficiency in its use of available tax bases. Growth and development of the economies is the longer-term solution to solving the structural problems of tax collection from broad tax bases. In terms of the VAT, these structural constraints are evidenced in a narrow effective tax bases. This issue is addressed in the next section on VAT efficiency.

6.3. VAT and sales tax efficiency

The efficiency of a VAT or sales tax is a measure of the share of the potential base that is effectively used. It is measured by working backwards from the actual collections which given the tax rates applied indicate the effective tax base which can be compared to the potential tax base. If taxes are collected at different tax rates, ideally the revenue collections would be subdivided by tax rate to estimate the effective base. In the case of broad-based consumption taxes, where most (if not all) of the revenues are collected at the standard rate, the convention is to estimate the effective tax base using the standard sales tax or VAT rate. Ideally, a detailed analysis of the structure of the economy based on national accounts and input-output relationships to estimate the theoretical or potential sales tax or VAT base.[89] Here the focus is on more qualitative and comparative analysis across countries. To achieve this two efficiency measures are typically calculated: one is the GDP-efficiency; the other is the consumption-efficiency.

GDP-efficiency of a sales tax or VAT is the effective base over GDP. While GDP is not the potential base of a consumption tax, this measure is useful to get an estimate of

(i) how much added revenues will a 1% growth in GDP yield, or

[89] For methods for estimating the potential base of a VAT, see for example, Howell H. Zee, "Value-Added Tax" in P. Shome (ed), *Tax Policy Handbook*, Fiscal Affairs Department, International Monetary Fund (1995), and Anthony J. Pellichio and Catherine B. Hill, "Equivalence of the Production and Consumption Methods of Calculating the Value Added Tax Base: Application in Zambia," IMF Working Paper (WP/97/67), June 1996

(ii) how many percentage points will the VAT rate need to be raised to yield an added 1% of GDP in revenue.

For example, if the GDP efficiency is 0.3, then a 1% growth in GDP yields about 0.3% in tax revenues. Alternatively, the VAT rate will need to be raised by at least 3.3 (or 1/0.3) percentage points to raise an added 1% of GDP in revenues.

Consumption or C-efficiency is typically measured as the effective tax base over final consumption by the private sector ($C_{private}$ - as measured in national accounts) or

C-efficiency = (GDP efficiency)/($C_{private}$/GDP).

This is a better proxy for the effective use of the consumption tax base. Alternative measures are to use

(a) total consumption (private plus government consumption) (or C) under the assumption that government consumption is taxable, or
(b) total consumption reduced by the government wage bill (C – Government Wages) which recognizes that only purchases of goods and services are the potentially taxable.

The latter measure is theoretically closest to the true measure of a VAT or sales tax base before making adjustments for exemptions and other inclusions. The traditional C-efficiency measure can be an overestimate of efficiency, while the total consumption efficiency measure can be an underestimate, particularly where government consumption expenditures are a large share of GDP.

Table 6.6 gives the averages of the four sales tax and VAT efficiency measures for 1997-2001 for the SADC Member States, while Table 6.9 gives the year-by-year estimates through 2003 (where available) and distinguishes between sales tax and VAT efficiencies.

Generally, sales tax and VAT efficiencies for SADC Member States averaged 29% relative to GDP, 34% relative to total consumption, 38% relative to consumption less government wages, and 44% relative to private sector consumption. These are similar to the VAT efficiency measures estimated by the IMF for countries in Sub-Saharan Africa with VAT as shown in Table 6.8, but lower than countries in most other regions where GDP-efficiencies averaged in the range of 35% to 38% and $C_{private}$ efficiencies ranged from 57% to 64%.

Among the SADC Member States, however, the range of sales tax and VAT efficiency is large, from a low GDP-efficiency of 3.2% in DRC to a high of 46.2% in Namibia,[90] and from a low $C_{private}$-efficiency of 4.6% in DRC to a high of 75.5% in Namibia. Some of the variance in C-efficiency comes from the variance in consumption (C) over GDP, some of the variance in consumption over GDP comes

[90] Namibia charges a 30% VAT rate on a range of luxury goods including some major categories such as motor vehicles, tobacco products, wines, entertainment equipment, perfumes, toiletries, etc. This will arise the apparent efficiency of the tax which assumes all goods are taxed at the standard rate of 15%. Zimbabwe also charges a luxury goods tax rate of 25% on motor vehicles tax raises the apparent tax efficiency somewhat.

from variations in GNDI over GDP, and some of the variance in $C_{private}$ efficiency comes from the variations in government consumption as a share of GDP.

Table 6.7 gives the average GNDI/GDP and C/GDP for SADC Member States between 1992-1996 and 1997-2001. Lesotho and to lesser extent Mozambique, Namibia and Swaziland have had GNDI exceed GDP by a wide margin because of positive net transfer and net foreign factor receipts, while Angola and DRC have had GNDI below GDP by significant margins. GNDI is the basis of consumption and saving in a country. When GNDI is significantly higher than GDP, it is likely that C can exceed GDP. Hence, even if C-efficiency were the same across countries, GDP-efficiency would vary because of the variation in C/GDP. On average GNDI tends to exceed GDP among SADC country members and C/GDP at 88% (Table 6.7) and $C_{private}$/GDP at 72% (Table 6.6) are higher than in the non-Sub-Saharan African regions in Table 6.8, which are in the range of 58% to 65% of GDP.

$C_{private}$ measures of VAT and sales tax efficiency can be biased upwards where government consumption is large and government wage bills are large relative to GDP. Table 6. 6 shows Botswana, Lesotho, Namibia and Swaziland with large shares of government consumption as a proportion of GDP. This results in large upward biases in $C_{private}$-efficiency measures, particularly in Namibia and Botswana.

Cross-country comparisons from Table 6.6 for C-efficiency adjusted for government wages for 1997-2001 show that Mauritius, Namibia, South Africa and Zimbabwe had efficiency ratios significantly above the average of 38%, while the DRC, especially and to a lesser extent Tanzania and Malawi have been significantly below average. Botswana, Swaziland, Mozambique and Zambia were somewhat below average, while Angola and Lesotho were somewhat above average.

Table 6.6. Average VAT/sales tax efficiency, SADC Member States, 1997-2001

Percentages

	VAT efficiency relative to					
	GDP	**C**	**C-gov wages**	**C private**	**Cpriv/GDP**	**Cgov/GDP**
Angola	21.0	36.7				
Botswana	17.7	29.6	35.0	57.0	31	29
DRC	3.2	4.0	4.1	4.6	71	10
Lesotho	44.8	36.0	41.6	46.2	97	27
Malawi	26.7	27.1	28.8	31.6	84	14
Mauritius	38.0	49.5	54.9	59.9	63	13
Mozambique	29.3	32.4	34.9	36.6	80	10
Namibia	46.2	51.0	62.6	75.5	61	29
South Africa	41.6	50.3	53.1	65.5	63	19
Swaziland	26.4	27.6	32.3	35.7	74	22
Tanzania	16.2	16.2	16.9	17.5	93	8
Zambia	31.3	33.3	35.6	39.0	80	14
Zimbabwe	37.8	43.8	50.5	55.7	68	18
Average	29	34	38	44	72	18

Table 6.7. Gross National Disposable Income (GNDI) and Consumption (C) as share of GDP, SADC Member States, averages 1992- 96 and 1997-2001

	GNDI/GDP		C/GDP	
	1992-1996	1997-2001	1992-1996	1997-2001
	Percentages			
Angola	96.6	84.3	78.4	61.0
Botswana	100.9	100.9	62.1	60.3
DRC	92.8	92.7	87.5	85.6
Lesotho	186.7	144.1	136.8	122.1
Malawi	102.0	97.7	100.1	98.8
Mauritius	102.6	102.7	75.7	76.9
Mozambique	112.1	102.8	111.4	92.7
Namibia	114.5	114.8	90.0	88.4
South Africa	97.5	97.0	82.2	82.8
Swaziland	119.4	112.4	98.2	95.7
Tanzania	108.5	104.6	99.4	95.0
Zambia	Na	96.5	99.9	103.3
Zimbabwe	98.2	97.5	82.1	86.8
Average	111	104	93	88

Table 6.8. VAT efficiency by region

Percentage

	VAT efficiency relative to		
Region	**GDP**	**$C_{private}$**	**$C_{private}$/GDP**
Sub-Saharan Africa	27	38	71
Asia and Pacific	35	58	60
Americas	37	57	65
European Union (including Norway and Switzerland)	38	64	59
Central Europe, Russia, Baltic and Other States	36	62	58
North Africa and Middle East	37	57	65
Small Islands	48	83	58

IMF Staff estimates, The Modern VAT (2001) Table 4.1

Table 6.9 gives year-by-year efficiency rates for 1997-2003, and differentiates the sales tax years from the VAT years. For those countries switching to a VAT over this period, they generally show an improvement in tax efficiency (C- government wages).

Mauritius shows an increase from 53% to 68%, and Tanzania from 15% to 23%, but Namibia has shown no significant change or possibly a decline based on preliminary estimates. Preliminary data for Botswana for 2003 suggest a massive increase in tax efficiency from 38% to 70% indicating the switch from a selective sales tax to a broad-based VAT including large public sector consumption base. Mozambique switched in from a turnover tax in 1999 from a turnover tax at a standard rate of 5% collecting about 3.3% of GDP to a VAT at 17% collecting 5% of GDP. Given the difficulty in estimating the effective tax rate under a turnover tax because of potential

tax stacking as goods and services move through multiple stages of production and trading, it is difficult to estimate the effective consumption base of the turnover tax.

For the countries with a somewhat longer VAT history (Malawi, Zambia and South Africa), the experiences were similar to the post-1997 cases just discussed with the exception of South Africa.

- In Malawi, the tax efficiency rose from 16% to 22% in the early 1990s after VAT was introduced in 1989, and then rose to around 30% by the late 1990s, but it dropped significantly to 24% by 2002 with the exemption of petroleum products and the imposition of excise duties on these items in place of VAT.
- In Zambia, tax efficiency increased from around 20% under the sales tax to over 30% after the VAT was introduced in 1995 and has subsequently risen to 40% in 2002.
- In South Africa, by contrast, when the 10% VAT replaced the 13% sales tax in 1991, the C-efficiency (adjusted for government wages) dropped from 70% to 61% by 1993, and then dropped further to 54% when the rate was raised to 14% in 1994, but has subsequently recovered somewhat to around 58% by 2003.

To some extent the switch from sales tax to VAT would have removed some tax stacking under the sales tax that would have raised the effective tax rate above the statutory rate and resulted in an overestimate of the effective tax base under the sales tax.

With the exception of South Africa, which already had a broad-based sales tax prior to conversion to the VAT, SADC Member States have experienced significant increases in tax efficiency as their effective consumption tax bases have broadened under the VAT. It is important to note, however, that the effective tax bases remain relatively small among the lower-income countries such as DRC (3%), Malawi (24%), Mozambique (35%) and Tanzania (23%). Lesotho, Swaziland and Zambia also remain below 50%. These relatively narrow sales tax and VAT bases reflect a combination of the structural features of the economies that constrain the tax capacity, limitations in the effectiveness of tax administration, and choices in the exemptions in the tax structure (which are reviewed in Chapter VI below.) The obvious impacts of a narrow base have already been discussed above - namely, lower tax revenue increases from economic growth, and higher tax rate increases being required to achieve any targeted revenue increase. There is also a less obvious, but important negative impact on the price responsiveness of the tax base to rate increases that are now discussed.

Table 6.9. VAT/Sales Tax efficiency relative to GDP, Consumption, Consumption less Government Wages, and Private Consumption, SADC Member States, 1997- 2003

			Financial year ending in						
	Type of tax	**Efficiency basis**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**
			Percentages						
Angola	Non-oil excises	GDP	*15.4*	*24.1*	*19.3*	*18.0*	*28.0*	*30.0*	
		C (Consumption)	*21.0*	*29.5*	*32.8*	*48.8*	*51.5*		
Botswana	Retail Sales Tax	GDP	*14.7*	*16.8*	*18.9*	*19.8*	*18.5*	*19.6*	**35.2p**
	VAT from July 2002	C (Consumption)	*25.5*	*29.2*	*30.8*	*32.2*	*30.5*	*32.1*	**57.7p**
		C - Govt Wages	*30.0*	*34.4*	*36.5*	*37.9*	*36.3*	*38.9*	**69.9p**
		C private	*47.4*	*55.0*	*60.2*	*63.5*	*58.9*		
DRC	Producers Turnover	GDP	*6.7*	*2.5*	*2.9*	*1.6*	*2.5*		
		C (Consumption)	*9.1*	*3.0*	*3.5*	*1.7*	*2.6*		
		C - Govt Wages	*9.5*	*3.1*	*3.7*	*1.8*	*2.7*		
		C private	*11.3*	*3.3*	*3.9*	*1.8*	*2.7*		
Lesotho	Retail Sales Tax	GDP	*46.0*	*46.9*	*45.9*	*41.2*	*43.9*		
		C (Consumption)	*35.8*	*37.4*	*36.4*	*33.5*	*36.9*		
		C - Govt Wages	*40.3*	*42.6*	*41.9*				
		C private	*44.8*	*47.9*	*48.0*	*43.6*	*46.9*		
Malawi	Manufacturers VAT	GDP	**22.7**	**28.5**	**26.7**	**28.6**	**26.8**	**24.0**	
		C (Consumption)	**23.2**	**29.0**	**28.1**	**28.6**	**26.8**	**22.8**	
		C - Govt Wages	**24.4**	**31.3**	**29.8**	**30.1**	**28.3**	**24.3**	
		C private	**26.6**	**33.3**	**32.6**	**33.1**	**32.2**	**27.1**	
Mauritius	VAT from Sept 1998	GDP	*36.5*	*36.1*	**36.4**	**41.5**	**39.6**	**47.1**	
		C (Consumption)	*48.1*	*47.8*	**48.1**	**53.4**	**50.3**	**57.9**	
		C - Govt Wages	*52.7*	*52.1*	**52.6**	**59.9**	**57.1**	**68.0**	
		C private	*58.2*	*57.8*	**58.0**	**64.5**	**60.9**	**69.9**	
Mozambique	VAT from 1999	GDP				**30.1**	**28.4**	**29.1**	
		C (Consumption)				**33.0**	**31.8**	**32.8**	
		C - Govt Wages				**35.4**	**34.3**	**35.3**	
		C private				**37.2**	**36.0**	**37.1**	
Namibia	Retail Sales Tax	GDP	*43.0*	*43.8*	*47.0*	*49.1*	*48.2*	**46.2**	**44.6**
	VAT from 2002	C (Consumption)	*46.3*	*49.1*	*51.4*	*54.3*	*53.7*		49.7p
		C - Govt Wages	*56.6*	*60.5*	*63.6*	*66.5*	*65.6*		60.7p
		C private	*69.2*	*74.1*	*76.3*	*78.4*	*79.3*		73.4p
South Africa	VAT	GDP	**40.4**	**40.9**	**41.7**	**42.2**	**42.6**	**43.3**	**45.0**
		C (Consumption)	**49.2**	**49.3**	**50.1**	**51.0**	**51.7**	**52.8**	**56.1**
		C - Govt Wages	**52.9**	**52.6**	**52.9**	**53.8**			**57.5p**
		C private	**64.6**	**64.7**	**65.7**	**66.1**	**66.5**	**68.7**	**73.0**
Swaziland	Retail Sales Tax	GDP	*26.7*	*25.5*	*27.4*	*26.6*	*25.6*		
		C (Consumption)	*27.6*	*26.5*	*28.5*	*28.0*	*27.4*		
		C - Govt Wages	*32.5*	*30.9*	*31.8*	*33.3*	*33.0*		
		C private	*34.3*	*37.1*	*35.0*	*36.8*	*35.5*		
Tanzania	Sales Tax	GDP	*14.4*	*13.4*	**17.3**	**16.3**	**19.5**	**20.5**	
	VAT from 1999	C (Consumption)	*14.7*	*13.6*	**18.5**	**17.9**		**22.1p**	
		C - Govt Wages	*15.3*	*14.2*	**19.3**	**18.7**		**23.1p**	
		C private	*16.0*	*14.7*	**19.9**	**19.2**		23.8p	
Zambia	VAT	GDP	**29.9**	**28.7**	**32.8**	**32.6**	**32.2**	**28.6**	
		C (Consumption)	**33.0**	**29.9**	**32.4**	**35.6**	**35.7**	**36.2**	
		C - Govt Wages	**35.5**	**31.7**	**34.2**	**37.8**	**38.6**	**40.3**	
		C private	**40.9**	**35.8**	**37.1**	**39.7**	**41.7**	**42.9**	
Zimbabwe	Retail Sales Tax	GDP	*36.1*	*41.9*	*39.1*	*32.8*	*39.2*	*49.4*	
		C (Consumption)	*42.3*	*48.8*	*46.4*	*38.5*	*43.1*	*55.3*	
		C - Govt Wages	*50.4*	*48.8*	*55.1*	*48.2*	*50.2*	*64.4*	
		C private	*52.5*	*61.0*	*56.6*	*53.8*	*54.6*	*68.2*	

Note: *Sales or turnover tax in italics*
VAT in bold
p preliminary estimate

6.4. Limits on revenue increases from higher tax rates

One of the attractions of a broad-based consumption tax is that the moderate reduction in the tax base that occurs when a tax rate is increased. Any tax base becomes problematic if the base contracts by a large share to any increase in the price as may be caused by an increase in the tax rate. The tax base may shrink in response to the tax rate increase such that only a relatively small revenue increase is achieved, or in more extreme cases the revenues even fall as the rate is increased if the base contracts rapidly.

Typically, when all the prices increase of a large collection of goods and services forming a high share of expenditures of consumers, the price elasticity of demand of all the goods and services taken together will be close to –1. This means that if all the prices increase by 1%, the quantities purchased will contract by 1%, which also leaves the total value of expenditures constant through the quantity contraction offsetting the price increase. When a broad base of goods and services are taxed and the total expenditures of the taxpayers are constant, therefore, the overall quantity response to an increase in the standard tax rate on this broad base is expected to be consistent with a price elasticity of demand of approximately –1. This is a common assumption in analyzing the revenue effects of tax rate changes on a broad-based consumption tax.

Within this broad collection of goods and services, however, are both essential items such as basic food, water, shelter and clothing as well as non-essential, optional and luxury consumer goods and services. The essential items are typically less price responsive, while the non-essential ones are more price responsive. From the analysis of tax capacity and tax efficiency, it was observed that in many of the SADC Member States less than half potential tax base is effectively taxable. This raises the question of which types of goods and services are being excluded, the more or the less price responsive items? If the less price responsive items are excluded, then the actual narrow base of taxable goods and services can be expected to be more price responsive than the potential broad tax base.

In low-income economies a large share of consumption of the population is met through the non-monetary and informal sectors. In addition, expenditure studies typically show that the poor will spend a high share of their income on essential items such food, water, and shelter. If these essential items are being self-supplied as in the non-monetary sector or where items are being purchased from small and informal sector businesses outside of the consumption tax system which typically excludes businesses with small turnovers. Some governments, for reasons of both equity and feasibility of administration, also explicitly exempt items such as unprocessed food or agricultural sector outputs. This results in the less price-responsive goods and services being left in the tax base. Hence, the narrow tax base is not only smaller, but also more price responsive. This limits the tax revenues that can be achieved by raising the standard tax rates of a sales tax or VAT. As it happens, Malawi has provided a useful actual tax experiment the 10-year period from the mid-1980s to 1990s when it raised its standard surtax rate in steps from 20% to 35% and then lowered it back to 20%. The tax yield response to this major change in tax rates is studied in the next section.

Malawi: A case of ineffective high standard surtax rates

The VAT is often viewed as a major source of potential revenue enhancement to replace revenues as trade taxes are reduced and, even more generally, to reduce government deficits. While a broad-based VAT in developing countries can be expected to increase its tax yields over time as tax compliance improves and the formal sector expands as a share of an economy raising the effective size of the VAT base, in the medium term, increased VAT rates have to be considered as a method of enhancing VAT yields. Currently, standard VAT rates among SADC Member States range from 10% to 20%. Raising VAT rates in the countries with standard rates at the lower end of this range represents a credible way of gaining significantly increased yields, but for countries at the top end of the range, raising rates can be expected to yield only limited additional revenues.

Malawi provides an interesting case study of the revenue effects of varying the standard tax rate in the range above 20%. Malawi, in the latter part of the 1980s, raised its sales tax rates significantly in an attempt to close its budget deficit. It also undertook a major tax reform program, which included the conversion of its sales tax, known as the "surtax," to a destination-based, credit-method VAT in 1989. It retained the name of the tax as the "credit-method surtax" and kept the point of the tax at the manufacturing level. Prior to the introduction of the credit method structure, Malawi had raised its standard surtax rate from 20% to 25% in 1984/85 and again to 30% in 1985/86. See Table 6.10. At that time, the surtax rate on imports was also 20% higher than the surtax rate on domestic supplies (for example, a 20% domestic rate was charged at 24% on imports), but the large majority of the surtax revenues were collected on domestic sales given imported raw materials and capital equipment where exempt inputs by registered traders before the credit method was introduced. As part of the tax reforms, in 1987 the standard rate on imports and domestic supplies was made uniform, but raised again to a peak of 35%. With the introduction of the credit method in 1989/90, however, the surtax rate was lowered to 30%, and then furthered lowered every two years subsequently back down to 20% by 1993/94.

Table 6.10. Surtax rates and revenues, Malawi 1982/83-1993/94

Fiscal years[a]		Standard Surtax Rate (Rate on imports)	Average Surtax Revenue[b]/GDP
From	To		
1982/83	1983/84	20% (24%)	4.56%
1984/85		25% (30%)	5.31%
1985/86	1986/87	30% (36%)	5.54%
1987/88	1988/89	35%	5.90%
1989/90[c]	1990/91	30%	5.96%
1991/92	1992/93	25%	5.44%
1993/94	2000/01	20%	4.95%

a. Fiscal year is ends on March 31

b. Includes Accommodation and Refreshment Tax which was incorporated into Surtax in 1993/94

c. Credit method surtax introduced in 1989/90

Source: Ministry of Finance data

The remarkable feature of this roller-coaster tax rate ride that was that the revenue yield as a share of GDP only rose modestly from about 4.6% prior to the rate increases to a peak of about 6%, and then only declined to 5% as the standard surtax rate dropped from 35% back to 20%. Interestingly, the revenue yield stayed in a tight range of 5.3% to 6% of GDP as the rate varied between 25% and 35%.

This suggests that the price responsiveness of the surtax base was high. In fact, it appears that the standard surtax rate rose into the range of the maximum revenue yielding tax rate for the surtax base.

These observations can be analyzed somewhat more formally by considering the price effects of raising sales tax rates on the size of the effective tax base of a consumption tax. Considering the case of constant cost supply, the revenue yield can be expressed in terms the tax base, the tax rate and the price elasticity of demand [91] as follows:

$$R/Y = (pQ/Y)t(1+\eta t) \qquad (1)$$

where : R/Y = *surtax revenue yield or revenues as a share of GDP* (Y)

pQ/Y = *value of taxable sales as a share of GDP without tax in place*

t = *standard surtax rate*

η = *price elasticity of demand of taxable goods at the price and quantity without tax*

For the revenue yield to fall from 6% to 5% of GDP as the tax rate is reduced from 35% to 20% requires a high price elasticity of demand of around –1.5. Typically for a broad-based tax such as a VAT, where most of final consumption is targeted, the price elasticity of the bundle of all taxable goods is expected to be close to –1, as this implies that total consumption will remain at the same expenditure value as the tax rate or price increases. If the price elasticity of demand for taxable goods had been about –1 in Malawi, then the surtax revenues would have risen to about 7% of GDP (rather than 6%) when the standard rate was raised to 35%. It is also of interest to note that at the high price elasticity of demand of –1.5, the maximum revenue yield would be reached at a tax rate of 33%. The tax rate yielding the maximum revenues is given $-1/(2\eta)$. This is consistent with the revenue yield in Malawi remaining nearly invariant as the surtax rate was varied in the range of 30% to 35%.

What are some possible reasons for the price elasticity of demand being high and, therefore, variations in the revenue yield being dampened as the Surtax rate changed? First, if the tax base exempts a large share of consumption, particularly unprocessed foodstuffs that make up a high share of consumption particularly of the poor, then the elasticity of demand for the remaining taxed goods can be higher than one**.** Similarly, exemption of a wide range of services and the prevalence of a large informal sector,

[91] Price elasticity of demand (η) is defined at the prices and quantities that be traded without the tax in place as given by p and Q. The demand curve is assumed to be approximated by a straight line over the range of tax rates applied. If a less price responsive demand curve than a straight line were assumed, then a higher price elasticity of demand would be required to get the same lack of revenue response observed in Malawi. For example, a constant price elasticity of demand would require a price elasticity of demand of about –3.2. This is not reasonable. It would also imply maximum revenue yielding tax rate of 50%. This is not consistent with observed revenue performance in Malawi.

with turnover rates falling below the minimum turnover level, and large non-monetary sector further restrict the taxable base of sales.

The smaller the tax base and with more "luxury" goods that were included in the base (as opposed to the exempted necessities such a unprocessed food), the feasibility and expectation of a high price elasticity of demand rises with the significant possibilities for consumption substitution to untaxed goods and services. Moreover, a small share of luxury goods were subject to high tax rates above the standard surtax rate. If these high-tax rate items are substitutes for goods at the standard rate, then the price elasticity of goods at the standard rate would be higher, as when the standard rate was raised increased luxury surtaxes would be collected masking the decline in revenues from goods at the standard rate. Furthermore, tax compliance is expected to decline as the incentives for tax evasion rise with the very high standard tax rates of 30% and above. This would result in an increase in the effective price elasticity of demand for taxable goods being observed.

It is important to recognize that the Malawi surtax rate changes occurred without any systematic reduction in the average tariff rates charged on imports that would have resulted in lower domestic prices and offset the increases in the surtax rates. Tariff rates during the late 1980s and early 1990s were both decreased and increased. Effective import duty collections averaged around 3% of GDP throughout this period. If tariffs are systematically being reduced and replaced with higher consumption tax rates, then it is less certain that any increased consumption tax rates will cause any increase in prices. The squeezing of the tax base in response to tax-induced price increases, as discussed above, will not occur if the duty rate reductions offset the surtax or VAT rate increases.

Summary

High price elasticity of demand in conjunction with a narrow tax base (less than 50% C-efficiency, for example) can lead to tax rate increases being an ineffective tool to achieve significant revenue increases when the standard rate is already high. Both tax base widening and effective administration are required to enhance revenues directly and indirectly to support higher revenue yields from tax rate increases. The direct revenue effects will arise from the effective base broadening. The indirect effects will come from the lower price elasticities of demand of a broader tax base.

VII. Selective Tax Structure Issues

7.1 Introduction

The credit-method VAT based on the destination principle has two interrelated and powerful features.

- The first is that it results in the intended statutory tax rate being charged on final consumption of goods and services by the private and public sectors. This feature allows more precision in designing the intended effective tax rates on final consumption, including not charging tax on exports (by zero–rating) and on investment (by allowing input tax credits). This feature is often not achieved by alternative turnover, sales and excise taxes.

- The second is the "self-enforcing" aspect of the credit method where the buyer requires a VAT invoice from the seller in order to obtain the input VAT deduction or credit. This enhances compliance with the VAT.

Both of these features arise out of the chain of output taxation and input deductions (or taxation and credits) that occur as goods and services flow through the various stages of production and trade until they reach final consumption. At the point of final consumption or use, the tax becomes final at the rate charged at that final stage.

This ideal "VAT world" is undermined when this chain of taxes and credits gets broken. Breaks in the chain arise because of exemptions of certain businesses, sales to certain persons, or certain goods or services from the VAT, or because of failure to pay credits at all or on time for the VAT included in the costs of production. Another problem in the chain of production arises from government-supported producers where decisions have to be made about whether they are fully-fledged commercial members of the chain or not, and if not, become exempted.

The causes of these breaks in the chain of VAT taxation and credits are the main focus of this Chapter. It first lays out the broad causes of these breaks and their revenue and economic consequences, and then reviews the actual structures of the VAT systems of SADC Member States. For member countries with sales tax systems, the comparable features will be noted.

Breaks in the chain of VAT output taxes and input taxes or credits arise because of

i. Businesses not being required to register for VAT because of
   a. Businesses having turnover below a specified minimum level (which excludes small and micro, often informal businesses from the VAT);
   b. Specified output supplies of businesses being exempted (such as financial and insurance services); or
   c. The type of business or activity being exempted or outside the scope of the VAT (such as registered schools, diplomats, armed forces, public defense, national security and other non-commercial central government activities)

ii. Specified goods or services being exempted, which may result in businesses not registering as in "i.b." above, or registered businesses that also produce taxable supplies, not receiving input deductions on the inputs purchased to produce exempt supplies.

iii. Non-payment of refunds, or long or unpredictable delays in gaining credits or refunds for input VAT that is in excess of output VAT.

The tax revenue and economic consequences of non-registration, exemptions, and no or delayed refunds are as follows:

i. **A second tax base is created** when the input VAT paid by businesses is not deductible or creditable, but instead becomes a final tax. Where the exempt trade or unregistered business is at the final stage of sale to final consumers, tax revenue on the mark-up at this final stage of production is lost **and only the input VAT is collected**. This decreases the effective VAT base. **Where the exempt trade or business is at an intermediate stage of production or trade, however, taxes are still collected at the final stage of production *in addition to* the input taxes paid on purchases by the exempt or unregistered business.** This increases the effective VAT base, and hence the VAT revenues also increase, but it causes tax stacking or cascading as these input taxes get built into the costs of subsequent production.

ii. **Tax stacking from exemptions at intermediate stages of production results in complex and somewhat unpredictable results in the effective taxes that actually become built into the prices of final consumption goods and exports.** This clearly undermines the major attribute of the VAT of predictability of the effective tax rate on final consumption items and exports. This has unintended economic efficiency costs. It will cause economic allocation consequences in the economy because of the changes in relative prices arising across goods and services in the economy.

iii. **Exemptions result in negative trade protection for producers of tradable goods and services.** While exemptions cause domestic producers to include the input VAT in the costs of production of an exempt good or service, an importer of the same good or service pays no import VAT. This results in the competitiveness of the domestic producer being reduced relative to the import competition or border price of the export, in the same fashion as if the domestic producer had import duties charged on the inputs to production. This situation arises in many circumstances. For example, if domestically produced item such as fertilizers or pharmaceuticals are exempted, the domestic producers of these items will be at a disadvantage relative to VAT free imports because the domestic producer will pay VAT on all raw materials and capital equipment used in production. Another example arises where supplies to specified persons (such as diplomats, the government or some special industry such as the mining sector) are exempted. In these cases, the specified persons have a price incentive to import VAT free rather than buy from domestic producers that pay VAT on their inputs.

This illustrates that differences in VAT-induced negative protection for businesses across countries can have consequences for business location decisions in the same fashion as income tax incentives or import protection.

iv. **Delays or failure to refund input VAT that is not offset by output VAT results in the same tax and economic consequences as exemptions**. Revenues are increased, tax stacking raises effective tax rates and negative protection is felt by the domestic producers of tradable goods and services. Refunds situations, however, tend to be concentrated in a few situations:

(a) businesses with a high share of exported or other zero-rated supplies, and
(b) businesses undertaking investments in inventory or plant and equipment.

As a result the negative consequences are concentrated on the very activities (exports and investment) that the VAT structure is intended to alleviate. If this situation pertains in one country as opposed to another it could affect investment location decisions.

Non-payment or delays in payment in refunds can arise because of tax administration problems or because of legal or policy structures restricting the payment of refunds. This Chapter will focus on the legal structures affecting the rights to refunds of input VAT by businesses in different situations. It is also of interest to note that in some countries exemptions have been used to avoid the problems of delayed refunds, but the revenue and economic consequences are the same – only exemptions guarantee that they happen.

Two further observations on the causes and consequences of chain breaking are important to note.

- First, **the revenue and incentive consequences will be scaled up the higher the standard VAT rate**. These effects of exemptions are higher in the countries with the higher VAT tax rates. Unfortunately, the higher rates also tend to prevail in the countries with the lower tax capacities, and hence, narrower effective bases.

- Second, it is important to distinguish between the reasons a country is not registering or exempting certain types of business. The core reasons for not requiring registration are:
  (a) the tax administration and compliance costs are too high relative to the revenues, such as may be the case with small businesses, or
  (b) the measurement of the output supplied is difficult or infeasible, such as is the case with such financial services (particularly financial intermediation and insurance) or public goods (such as defense) where the supply is difficult or impossible to trade in a market place.

- Where the VAT administration is feasible and the costs of administration and compliance are reasonable, then some policy reason relating to reducing the tax burden on the poor or providing some development incentive may be the motivation. In this case the tax structure choices are then broader. These reasons and their related economic effects become the major concern in reviewing VAT structures.

Government supported activities

Exemptions are also used to clarify the scope of the VAT. VAT is targeted at final consumption, and hence, is charged on all supplies leading up final consumption by households or government. Even though the government may be producing public goods or services, by their very nature, pure public goods cannot command a market price, and hence, are not self-financing and have to be financed out of tax revenues.

VAT laws typically target business or commercial activities (whether for profit or not), or supplies of goods or services for a consideration by all persons, individuals and legal entities. The consideration or sales revenues received by business or commercial activities are expected to cover the costs of production. Under this legal construct of the VAT, governments and their corporate entities are not in principle excluded from being taxable suppliers unless their supplies are made for no consideration. For many public services this is not an issue, but for many the government or its agencies may be collecting fees or user charges in full or part payment for the service, such as health, education or printing and publishing services.

Where only part payment of costs is being collected, the government is obliged to finance or subsidize the residual uncovered costs. The extent of the subsidy may be explicit where the supplier is a separate legal entity, but may be implicit where the supply is by a government department. Such services may be in competition with private suppliers, for example, public schools in competition with private. A gray area emerges about which public sector supplies should be taxable, and how to determine the taxable value and which input taxes should be deductible.

Where government subsidized services are being supplied, output tax is only charged on a partial price and the full market value is not bearing tax. Consequently, input taxes will be deducted that relate to the subsidized (exempt) portion of the supply.

Three solutions are possible to correct this:

i. require tax to be charged on the market value, which could be estimated as the sum of the user-charges plus subsidies received if these result in full cost recovery, or
ii. disallow input tax deductions in proportion to the subsidized costs (which loses the tax on the subsidized share of the value added), or
iii. exempt the supplies (which loses the tax on the full value added.)

If tax is only charged on the user charge and not on the subsidized share of the full value, but all input taxes are fully deductible, then the overall taxes may become negative. This can be illustrated as follows

If an entity receives a subsidy at the rate of "s" on its user charge, "u", then the market price can be estimated as the costs covered by the user charge plus subsidy or u(1+s). If VAT is charged at rate, "t", on this full cost, and if the share of inputs that paid VAT is "α" of the full cost, then the VAT collections are: ut(1+s)(1-α).

If VAT is only collected on the user charge, but all the input VAT is deductible, then the VAT collection becomes ut(1-(1+s)α). This latter amount of VAT can be negative if (1+s)α > 1, which can be the case if, for example, α > ½ and s > 100% of the user charge (or the subsidy is more than 50% of the full cost.) This could be the case in a highly subsidized school, for example. It is also notable that as the subsidy gets larger, the output tax owed actually becomes larger than the user charge if s > (1-t)/t.

The approach of grossing up user charges by the subsidy received to get an estimate of the market value makes sense for the taxation of subsidized outputs if (i) the subsidy is modest, and (ii) the entities receiving the subsidy are competing in the market place, and (iii) the desired after-tax market price is still achieved for the subsidized good or service.

Where large subsidies are offered, however, and/or the share of input costs paying input tax are high, or if the market value is difficult to determine, then exemption may be the preferred option. In fact, if the government is subsidizing the service across all suppliers for policy reasons to lower the market price or user charge below the full cost, then charging VAT offsets some of the subsidy and undermines the policy intent. A VAT exemption and a lower subsidy would have the same fiscal effect. The subsidy would also need to offset the input VAT costs if the entity is exempted and needs to cover its full costs (including input taxes.) Notice that this is the same result that would arise if either:

(a) the entity was zero rated and the government had to credit the entity with the input VAT instead of paying a higher subsidy, or

(b) the entity was given the right to buy inputs at a zero tax rate from suppliers, in which case the government needs to monitor the correct application of such zero rating.

Exemption and a higher subsidy rate is a simpler solution administratively. Where an entity is conducting commercial activities as well as government subsidized activities, then the commercial activities should be taxable, while the government subsidized or supported supplies should be exempted.

A parallel situation exists with donation-supported charitable organizations where partial user charges are applied on some of its outputs. Is this output competing with for-profit organizations? Is there a public policy purpose in the supply being at a subsidized price? The former would argue for taxation and the latter for exemption (unless the input taxes are large offsetting the benefits of any donation.)

7.2 Selected Features

The following features of VAT systems across the SADC countries are reviewed in this Chapter:

i. Minimum turnover level for registration, and whether voluntary registration is permitted
ii. Exemptions of goods, services and supplies to specified or privileged persons
iii. Zero rating of goods, services and supplies to or by specified or privileged persons
iv. Any legal restrictions or privileges in the payment of VAT refunds

This review will allow some summary comments to be made on the treatment of certain important sectors, namely: small business, agriculture, and the public sector. It will also reveal differences across countries that may be of concern in coordinating tax policies causing differential investment incentives.

For countries with sales taxes or turnover taxes, the distinction between zero and exemptions does not exist. A turnover tax offers no input tax offsets. Under a sales tax, inputs into a taxable business are either purchased tax exempt or input tax credits or deductions are offered in a similar fashion to the credit method VAT. The minimum turnover for registration, the structure of exemptions and the treatment of inputs into business will be identified for these countries.

Minimum turnover

VAT systems generally have a minimum turnover limit of taxable supplies for compulsory registration. Most countries with VAT systems also allow voluntary registration of small businesses at the discretion of the Commissioner or Director of VAT. Table 7.1 shows that in the SADC region the minimum turnover for *compulsory* registration varies from a low of about $11,000 per year in Mozambique to a high of around $107,000 in Mauritius. Given the high variation in incomes across the countries (see Table 2.2), it is useful to standardize these turnover amounts against GDP per capita to get an estimate of the relative real sizes of business at this minimum turnover level across countries. Table 7.1, shows that when expressed in terms of the per capita GDP units, that Lesotho and Malawi have the highest “real” minimum turnover rates, followed by Mozambique, Tanzania, Zambia and Zimbabwe, and then the countries with the highest income levels, Botswana, Mauritius, Namibia and South Africa, have the lowest “real” minimum turnover rates. Countries such as Mauritius also specify some types of business that have to register irrespective of their turnover rates.

Table 7.1. Minimum turnover of taxable supplies for compulsory registration in SADC Member States with VAT systems

Country	Tax type	Minimum turnover of taxable supplies for compulsory registration			Year	Voluntary registration permitted?
		Local currency	US$	GDP pc[c]		
Angola	Selective sales/excise tax at manufacturers' level	No lower limit			n.a	n.a
Botswana	VAT	P250,000 [a]	US$53,000 in 2003/04	17	2003	Yes, at Director's discretion
DRC	Turnover	n.a.	n.a.		n.a.	n.a.
Lesotho	VAT	M500,000 [a]	US$66,000	170	2003	Yes
Malawi	VAT	K 2,000,000	US$20,800	125	2003	Yes
Mauritius	VAT	Rs 3,000,000, but no limit for 28 specified businesses	US$106,700	28	2003	Yes
Mozambique	VAT	Normal M250,000,000 Simplified[b] M100,000,000	US$10,700 US$4,300	54	2003	
Namibia	VAT	N$200,000	US$26,000	15	2003	Yes
South Africa	VAT	R 300,000	US$39,500	15	2003	Yes, if turnover more than R20,000
Swaziland	Sales Tax	E 20,000	US$2,600	2	2003	Yes
Tanzania	VAT	Tsh 20,000,000 Tsh 40,000,000	US$18,800 US$35,000	69 138	2003 2005	Yes
Zambia	VAT	ZK100,000,000	US20,200	57	2003	Yes
Zimbabwe	Sales Tax VAT	Z$2,500,000 for goods; Z$500,000 for services Z$250,000,000	US$4,300 US$870 US$50,000	6 66	2003 2004	 Yes, if turnover more than Z$200 million

a. *Includes turnover of related or associated businesses*
b. *Small businesses under simplified registration pay 5% turnover tax*
c. *Minimum turnover as a multiple of GDP per capita*

In its 2004 Budget, Zambia doubled the turnover limit for compulsory registration to ZK200,000, but also removed voluntary registration, and has since introduced a presumptive tax for small businesses outside of the VAT. While raising the minimum turnover limit should make VAT collections more cost-effective (by reducing administrative and compliance costs of collecting from small businesses), the removal of voluntary registration puts small businesses at a competitive disadvantage if they are exporting, investing or supplying intermediate inputs to registered businesses. The short-term gains in simpler tax administration may be offset by the slow economic growth and job creation over the long run.

The high "real" minimum turnover level in the low-income countries exacerbates the impact of the adverse structural features in these countries identified in Chapter VI (such as large informal and non-monetary sectors), leading to low tax efficiencies, and high price responsiveness of the remaining tax base. This leaves a challenge of how to expand the tax base and improve the tax efficiency characteristics of these economies.

A further point of interest is that Mozambique has two turnover registration levels. A higher one for the normal VAT and a lower one for small businesses that have to pay a lower flat turnover tax rate. This allows for indirect tax collections from small businesses without the higher compliance and administrative costs of a VAT. Tanzania actually also has a similar turnover tax structure for small unincorporated business with turnover below the VAT minimum turnover level, but in this case the turnover tax is an elective housed in the income tax rather than the VAT. The turnover tax is also an elective and has a complicated structure involving increasing turnover rates over three brackets. It also had effective presumptive taxes on small traders under its stamp duties as well having a range of business license fees. Tanzania, however, has recently doubled its minimum turnover level and restructured and rationalized its presumptive taxes on small business. Zambia introduced a presumptive tax in 2004. Mauritius is also considering implementing a presumptive tax on small businesses.

The use of a simple turnover tax of around 2% for small unincorporated businesses in place of both the VAT and income taxes is sometimes referred to a as a "unified" tax. For informal micro businesses, which generally do not issue invoices or maintain books and records, even turnover taxes are difficult to apply, as the sales values cannot be objectively determined. In these cases lump sum taxes (typically annual payments of a fixed sum) can be used. These fixed amounts can be scaled by market size and physical indicators of business size.[92]

Chapter VI showed that many countries in the SADC region have low tax efficiencies (see Tables 6.6 and 6.9 above) indicating that large portions of the potential tax bases are excluded from the VAT, turnover or sales tax. Much of this missing economic activity is in the small and informal business sectors and small-scale farmers below the minimum turnover levels for a VAT and below the minimum income level at which individual are required to pay income tax. The concept of a unified presumptive tax is to target this small and micro-business activity in a cost-effective and equitable manner to expand the tax base, and to make for a smoother transition as businesses grow and graduate from the informal to formal sectors, and from small business operations to full VAT and income taxpayers.

These types of presumptive tax structure should be pursued across all SADC countries to expand the VAT base to a broader base given the low VAT efficiencies observed. This base expansion will reduce the pressures to increase the VAT rates on effectively narrow bases, which, in turn, tend to further restrict the base as consumption shifts away from taxed goods and businesses resort to more tax evasion.

[92] Typical physical indicators of business activity include seating capacity of a restaurant or bus, rooms in a hotel, floor space of a business, etc

These types of presumptive taxes, however, are more suited to administration by local authorities than central revenue agencies, which are typically designed to administer self-assessed taxes using high technology approaches. Presumptive taxes require more low-skilled and more labor-intensive enforcement methods, better suited to local authorities. Typically, local authorities also administer all property related services and taxation, allowing for the easier identification of all local business activities on a continuous basis. Nevertheless, co-ordination of presumptive taxes would be necessary between local and central authorities, particularly in regard to taxpayer identification and registration, if these are to act as a unified tax of business activity below the minimum compulsory turnover level of a VAT. Arguably, in small countries (by size and population), the central tax administration may be able to cost-effectively administer a presumptive tax, but this is less likely in larger countries.

Exempt and Zero Rated Items and Persons

See Appendix B for listing of exempt and zero-rated items and persons for each SADC Member State. Data in Appendix B shows certain consistent patterns, but also significant variations in the use of VAT exemptions and zero rating. All countries zero rate exports and most transportation and ancillary services related to international travel. All countries exempt financial and insurance services, but not all define them exactly the same way. Most countries exempt public education services, public health services and either exempt or zero rate pharmaceuticals and medical equipment. Some zero rate a range of public transportation services. Most countries exempt a range of public utilities – piped water or water supplied to domestic sector, certain local government services, electricity supplied to domestic sector and some telecommunication services. A number of countries exempt or zero rate oil products and only make them subject to import and/or excise duties.

The lower income countries tend to exempt unprocessed agricultural outputs to avoid the difficulties of administering the VAT in the agricultural and rural areas and to lower basic food prices, while the higher income ones tend to zero rate a range of basic foodstuffs to avoid any tax burden from these products. Where agricultural products are exempted, typically either zero rating or exemptions will be provided for a range of key inputs in the agricultural sector to minimize the costs of input VAT being included in the price of basic foodstuffs.

All countries exempt for VAT a range of imports normally exempted from import duties, such as goods in transit, passenger personal baggage, personal possession of people changing residence, temporary imports and exports, containers, etc. Typically, countries exempt imports for diplomats, aid agencies, emergency relief, and various charitable organizations. The VAT treatment of domestic supplies to these privileged persons differs across countries from being eligible for refunds to being exempt or zero rated or taxable.[93]

[93] In the case of Tanzania, certain supplies and imports are eligible for tax "relief". It is unclear whether this means such supplies are exempt or zero rated. Tax exemptions in taxation usually mean the specified item is excluded from the tax base, but relief from tax usually means the rate of tax has been reduced fully or partially. No clear definition of VAT relief is provided.

In a few countries, purchases by the government and selected sectors (such as the mining sector in Tanzania) are exempt from VAT. This results in a situation of negative trade protection for domestic suppliers of goods competing with imports.

A number of countries differentiate the treatment of imports from domestic supplies. In a few of these countries, zero rating or exemptions are only provided to domestic suppliers of selected items, while imports are taxable. This results in VAT providing positive trade protection for domestic producers.

Overall, the variation in the specification of exempt and zero-rated items and persons across countries is large and poses a major challenge for VAT harmonization across SADC Member States.

Treatment of input taxes into business activities: input tax deductions and refunds

For countries with VAT

Under credit method VAT, a registered business typically is permitted to deduct input VAT paid where the purchased good or service is an input into the supply of a taxable good or service. This input VAT is typically offset against the output VAT. Where the input VAT exceeds the output VAT, the business is in a VAT credit position. The focus here is on how does the business get access to the value of this tax credit. Is payment by the tax authorities (normally referred to as a "refund") automatic for all or do some taxpayers require specific application or meeting of specific conditions before payment, or require carry forward until new output tax is generated? Any delay in capturing the value of the VAT credit (either through a delayed refund or having to wait for net output taxes in the future to deduct the input taxes carried forward), lowers its value, raises the effective VAT rate, and has cash flow consequences for the affected business.

Table 7.2 summarizes the VAT refund structures offered in the VAT legislation of the SADC Member States. Ideally, all legitimate VAT refunds should be paid back immediately, just as VAT inputs that are deductible and offset accrue immediately. At best "immediate" has to allow for the inherent claim filing and payment delays of a few weeks. Only some of the countries offer "immediate" refunds as a matter of principle. These are Namibia, South Africa, Zimbabwe, and Mozambique. Mauritius has fairly broad categories of business (exporters and other zero rated producers, and major investors) that would likely lead to most taxpayers in a credit position being able to claim "immediate" refunds. Mauritius, Mozambique, Namibia and South Africa also offer interest on late refund payments. Other countries, mainly the lower income countries, tend to favor businesses that are "regularly" in a refund position and give assurances of clearing the other claims within time periods varying between 3 and 6 months.

To deal with concerns of investors facing delays in refunds, Zambia allows deferment of VAT payments on specified capital imports until VAT input deductions are claimed, and Botswana allows deferment up to 25 days on import VAT. Malawi zero rates a large range of capital equipment items. The deferment approach requires

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Table 7.2. Structure of VAT refunds in SADC Member States					
Country	**Tax type**	**Refunds offered**	**Limitations**	**Special features**	**Year**
Angola	Selective sales/excise tax	n.a	n.a	n.a	n.a
Botswana	VAT	1.First offset against other outstanding taxes, then refund if regular exporter or certified manufacturer for export or international financial service center (S42) 2. Refunds to diplomats, aid agencies of VAT on domestic supplies (imports exempt) (S43)	1. Other refunds are payable at end of second month following due date for submission of return (or 3 months after credit was generated) (S42) 2. Withhold refund if returns not filed (S42)	Deferred import VAT up to 25 days in month following importation S15(6)	2002
DRC	Turnover	n.a.	n.a.	n.a.	n.a.
Lesotho	VAT	1. First offset against any outstanding tax arrears, otherwise carry forward 2. Regular refund claimants as determined by Commissioner can claim refund immediately	Refunds can be claimed after 3 months		2003
Malawi	VAT	1. First offset against any VAT overpayments, otherwise carry forward 2. Regular refund claimants as determined by Commissioner can claim refund immediately	Refunds can be claimed within 90 days	1. Import VAT by installments with interest 2. Zero rating of many capital equipment items	2003
Mauritius	VAT	VAT credits carried forward with except for 1. Inputs in proportion to zero rated supplies (or all inputs if "mainly" zero rated supplies) 2. VAT on capital investment where VAT is in excess of Rps 150,000 (S21-24)	1. No credit for VAT paid on passenger vehicle, accommodation, restaurant and entertainment expenses 2. Claim input tax within 24 months	Interest payable on refund claims not paid within 45 days	2003
Mozambique	VAT	Refund claims at request of taxpayer; priority to investors and exporters		Offers interest on overdue refunds Refund claims must be first audited and certified by an independent accountant	2004
Namibia	VAT	1. First offset against any outstanding tax arrears 2. Refund if regular exporter or credit less than N$10,000, otherwise within two months (S38)		Late refund payments earn interest at rate of 11% per annum unless audit required (S39)	2003
South Africa	VAT	First offset against any outstanding tax arrears, otherwise any complete claim is immediately payable (S44)		Late refunds earn interest from earlier of 21 days or 21 days from return being complete (S45)	2001

Swaziland	Sales Tax	n.a.	n.a.	n.a.	n.a.
Tanzania	VAT	1. Refund monthly for persons in regular credit position, otherwise 2. Outstanding credits refundable once every half year starting from month of first credit claim (S17)	Claim input tax within one year	Refunds payable within 30 days of due date or receipt of return	2001
Zambia	VAT	Credit amounts are refundable within 21 days of end of quarter including last day of tax period (S19); amended to payment within 30 days of lodgment of claim	Claim input tax within one year	VAT on specified list of capital equipment imports can be deferred until input VAT deduction is taken	2003
Zimbabwe	VAT	1. Refund claimable and payable if in excess of Z$500, otherwise credit carried forward (S44) 2. Diplomats can claimed refunds on domestic supplies	Claim input tax within six years		2004

effective customs controls and co-ordination with domestic VAT administration, and no domestic capital equipment producers that would be put at a disadvantage relative to imports. Zero rating can be effective assistance to registered users of capital equipment, but it represents a net VAT loss to the extent capital equipment is used by unregistered businesses.

Despite these not always favorable assurances of refund payments, it is actual refund payment behavior that determines the actual financial costs that businesses pay because of delayed refunds. Delays in refund payments basically mean that businesses face a higher effective (and somewhat unpredictable) VAT rate. This undermines a core reason for introducing a VAT system to support exporters and investors. **Accordingly, there would be a benefit to regional investment to encourage a harmonized approach to refund policy and practice, namely, to move towards more "immediate" refunding with in the limits of the administrative capacities of countries**.

Treatment of sales or excise taxes on inputs into business activities for countries without VAT

Angola

Angola has a single stage selective sales or excise tax at the manufacturers' level and on imports. It appears that exemptions are provided for inputs into production. It is not clear whether input exemptions are limited to registered manufacturers and only to the production of taxable goods and exports, or the production of all goods by a registered manufacturer or producer. It appears that excise taxes are paid on inputs purchased or imported by unregistered producers, service providers, primary sector producers, and traders. This would result in tax stacking and an increase in the effective tax rates.

DRC
DRC has a turnover tax for manufacturers, construction and certain services. No deductions or exemptions are provided for taxes paid on inputs into production.

Swaziland
Swaziland has a sales tax using the "ring system" where registered traders can import or purchase inputs and capital equipment used in the production.

VIII. Cross-Country Issues of VAT Policy Co-ordination

A broad-based VAT implemented using credit-method on a destination basis by a national government taxes imports, but zero rates exports. Its successful implementation clearly depends on the effective administration of taxes on international trade. Customs administration controls trade, collects taxes on imports, and verifies exports. When groups of neighboring countries establish free trade among these countries, border controls may get weakened or removed. This can fundamentally change the implementation of VAT from the perspective of any member country of the group. In the case of SADC, under the Trade Protocol, the movement towards a Free Trade Area (FTA) has been agreed. In addition, already within SACU, free trade has long existed. Within SACU, customs and excise duties are collected in a pooled fashion and border controls between member countries have been weakened, but not fully removed. In the case of the wider grouping of SADC, the FTA will be established by 2008 with complete removal of duties phased in by 2012. Under the FTA, customs border controls will remain, as country of origin rules will be used to determine trade from SADC Member States. SADC has the goal of a customs union by 2010 and a common market by 2015 that (as outlined in the SADC Regional indicative Strategic Development Plan (RISDP)). The nature of the border controls under the customs union and common market has not yet been determined. The nature of the border controls will dramatically impact the nature of the VAT structure that can be successfully implemented within SADC.

This Chapter explores the impact of removing border controls on the operations of a VAT and explores options for the VAT structure within a customs union or common market. These options will affect both the tax treatment of trade, the degree of harmonization of rates, the distribution of revenues among member countries and the role of any SADC authority required to co-ordinate the VAT system. This investigation will illustrate the impacts of removing border controls on the operation of a VAT using the credit-method on a destination basis, exploring the relative importance and nature of imports into SADC Member States, and then analyzing the alternative VAT structures that could be considered to deal with the problems of operating a VAT within a customs union or common market. Appendix D is also provided to give a more comprehensive background analysis to the operation of different VAT mechanisms with free trade within customs unions or common markets.

8.1. The impacts of removing border controls on the VAT

To examine the impact on VAT operations of creating an area with free trade with no border controls, the focus is put on international trade between member countries. It is assumed that a mature common market has been established as a single customs territory. (Equally, the effects of removal border controls could be examined in the case of a mature customs union such as SACU.) [94]

[94] A customs union is a group of countries forming one customs territory that allows the free flow of trade among these countries without quantitative restrictions or trade taxes. A common market is the same as a customs union, but also allows the free flow of capital and labor within the region. Both a common market and a customs union are free trade areas. Ideally, particularly in a common market,

Trades within such a common market for customs purposes are not treated as "imports" or "exports." Hence, such "**internal trade**" is similar to trade between the states of a federal state. In the case of the destination principle VAT system, "**external trade**" with countries outside of the common market is treated in the normal fashion: VAT is imposed on imports and zero rated on exports. This means that, viewed as a whole, the tax falls on consumption within the customs union or common market**.**

How the internal trade between member countries or states is treated, however, will effect which internal trades are taxed and at what rates, especially where countries have different tax rates, and which countries actually receive the revenues. Trade across internal borders will be analyzed by focusing on the tax structures affecting the firms or individuals acting as the "exporter" (firm 1) and "importer" (firm 2) and the tax flows accruing to the two countries.

In the first situation, the implementation of the destination-based VAT is analyzed with full border controls, while in the second without any border controls. The base case that will be considered first reflects the current situation in SADC, where all exports, including internal exports, from a country are zero rated and border controls are maintained. The second case removes the border controls. A number of ways for solving the problems that arise are then considered.

In these cases, see Figure 8.1, the output tax of firm 1 is $t_{o,}$ the VAT charged on imports is t_i, the input VAT deduction or credit received by firm 2 is t_{ic} and the final tax collected on the output of firm 2 is $t_{f.}$. Given these taxes charged and credited, the revenues collected by the two countries A and B are given by R_A and R_B, respectively.

Case 1 - Border controls and zero-rated internal exports
Zero-rated exports is the normal arrangement for a destination-based national VAT. In this case, internal exports are zero rated such that $t_o = 0$. See Fig 8.1. If the importer is registered for VAT, VAT is collected on the internal imports at t_i which is then credited to the registered importer, firm 2, such that $t_{ic} = t_i$. Firm 2, then collects the VAT on final sales of t_f. From these transactions, the total tax collected is $t_{f.}$ The revenues collected by countries A and B, R_A and R_B are given by:

$$R_A = t_o = 0$$
$$R_B = t_i - t_{ic} + t_{f.} = t_{f.}$$

If the importer is unregistered, then the import VAT, t_i is the final VAT (and country B forgoes ($t_{f.} - t_i$), and the revenue collections are:

$$R_A = t_o = 0$$
$$R_B = t_{i.}$$

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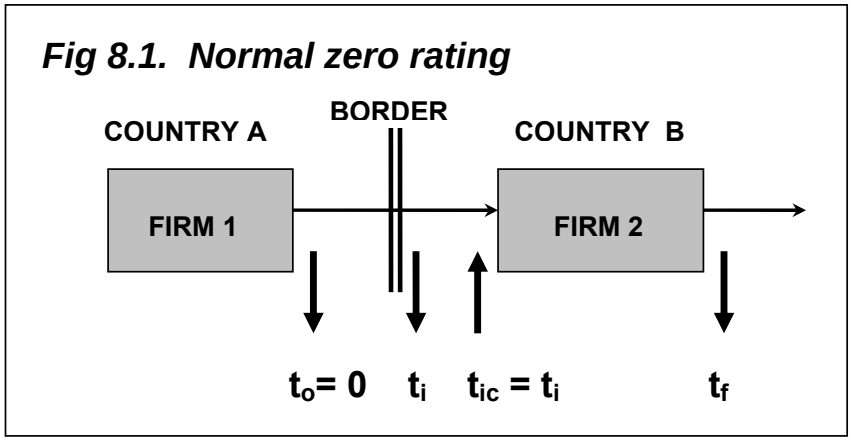
the economic borders would not be controlled to allow the free flow of goods and people within he area. The consequences of open economic borders are the prime issue for the operation of the VAT within a common market, or more generally, within an area allowing free trade.



In this case, country B collects the VAT on the final consumption of goods in that country at the place where the importer is registered (domestic VAT). In the case of imported goods by unregistered businesses or individuals, country B collects the VAT at the point of importation (import VAT). This means that country B may miss the taxation of any subsequent value added if it is conducted by unregistered traders, but collects the full tax if the importer is purchasing for final consumption, and may even collect additional VAT if the import becomes an intermediate input of a subsequent registered business before final consumption.

The import VAT characteristic of the credit-method destination VAT is important for many low-income countries where imports as a share of GDP are high and a significant share are purchased by unregistered traders. This will be discussed further below as will the treatment of imported services, which are not directed affected by the existence of customs border controls, but are affected by some of the alternative VAT structures when border controls are removed.

Border controls also assist country A controlling the internal exports by verifying the exports that are zero-rated rather than charged the standard VAT rate.

Case 2 - No border controls and zero-rated internal exports
Without internal border controls, a number of problems arise. Country A has no way of confirming exports to country B without the co-operation of country B such that fraudulent export claims by firms in A are likely. Country B, however, can only effectively assist country A confirm exports if the importer is a registered business. In the case of registered firms, import VAT cannot be collected at the border by country B, but can be self-declared by the firm at the time of filing a domestic VAT return (or VAT is collected by reverse charging by the importer) in which case a credit is simultaneously claimed, and hence, only the output tax paid.[95] See Figure 8.2.

[95] Note that self-declaration of the import VAT is effectively the same as the "deferred VAT" structure above such that $(t_i - t_{ic}) = 0$. See Appendix A, case I.a.ii.

In the case of unregistered businesses or individuals in country B importing from country A, country B has difficulty in enforcing any collection of import VAT such that no VAT is collected, $t_i = 0$. This is effectively the same as setting the import VAT at zero on internal imports ($t_i = 0$ and $t_{ic} = t_i = 0$).

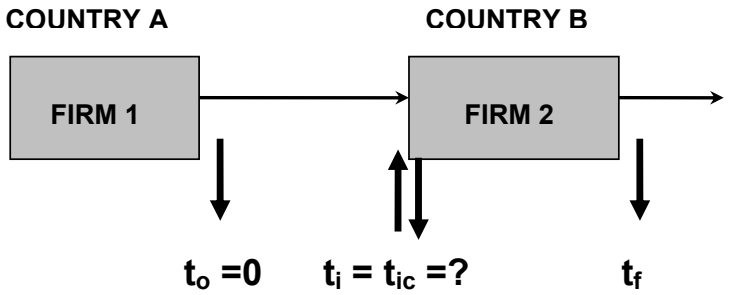
Without border controls and zero-rated internal exports, the revenue collections on internal trade by countries A and B if the importer is registered are:

$R_A = t_o = 0$ (or $- t_o$, if fraudulent exports)
$R_B = (t_i - t_{ic}) + t_{f.} = t_{f.}$

If the importer is unregistered, then the import VAT, t_i is the final VAT, and the revenue collections are:

$R_A = t_o = 0$
$R_B = t_i = 0$

Fig 8.2. Zero rating of internal exports without border controls



E-Commerce and distance shopping
It should be noted that "distance shopping" (sometimes also referred to as "distance selling"), which includes internal imports initiated by internet (or e-commerce) or other telecommunications or mail, is effectively the same as internal trade without border controls (unless all postal and shipping agents are under customs controls.) Similarly, the taxation of imported services is also effectively the same as internal trade without border controls. The VAT revenue collections effectively depend upon whether the importer is a VAT registered business or not.

Clearly, as shown in case 2, the dropping of border controls in the case of a credit-method destination-based VAT with zero-rating of internal exports poses a serious revenue risk.

- First, the exporting country is exposed to increased risks of export fraud to exploit the zero-rating of "exports". Typically goods are zero rated and supposedly exported – but actually remain for domestic consumption. This phenomenon has already been observed with SACU where border controls have been weakened, but not eliminated, and cross-border shopping is prevalent, for example, between Lesotho and South Africa.

- Second, the importing country loses all the import VAT on goods imported by unregistered importers. This can be a serious revenue loss if such import trade is a significant share of imports. Removing the VAT from this trading channel would also be expected to expand this type of trade at the expense of trade by registered businesses. The higher the share of trade by formal sector registered businesses and the lower the share of direct imports of final consumption goods by unregistered businesses, the smaller this problem. Hence, this problem may be more manageable within groupings of industrial countries such as the European Union, but much less so within groupings of low and lower middle-income countries such as within SADC.

8.2. Importance of VAT charged on imports

How large is this problem of final imports by unregistered business and individual importers amongst SADC Member States? As a start, imports are typically a high share of the economic activity in SADC. Table 8.1 shows that between 1992-96 and 1997-2001 on average imports as a share of GDP among the non-SACU SADC countries have been mainly in the range of 20% to 40% of GDP with the exception of Mauritius at close to 50% of GDP. Imports as share of GDP for the SACU countries have been even higher, in the range of 40% to 70% of GDP with the exception of South Africa at around 20%. It is likely that further regional trade liberalization will raise these import shares further, particularly for the smaller non-SACU countries. It is clear that VAT on imports is typically an important component of the overall VAT in SADC countries.

In addition, Table 8.2 shows the trade imbalances in goods and services on average between 1992-96 and 1997-2001 for SADC Member States. For 7 out of the 13 countries, there have been large trade deficits (over 10% of GDP). For a further 3 countries (DRC, Mauritius and Zimbabwe), trade deficits have been more modest. Only 3 countries (Angola, Botswana and South Africa) experienced trade surpluses. This implies that the destination VAT base (taxing imports and consumption) is the larger *potential* tax base than the origin VAT base (taxing exports and production).

Table 8.1: Imports as share of GDP, SADC Member States, averages 1992-96 and 1997-2001

	1992-1996	1997-2001
	Percentages	
Non-SACU countries		
Angola	30.8	37.8
DRC	14.3	24.1
Malawi	33.6	33.5
Mauritius	54.1	49.0
Mozambique	39.6	26.3
Tanzania	30.9	17.5
Zambia	22.6	23.0
Zimbabwe	32.6	32.5
SACU countries		
Botswana	40.2	45.8
Lesotho (%GDP)	105.6	89.8
Lesotho (%GNDI)	56.6	62.4
Namibia	41.7	45.0
Swaziland	83.7	77.8
South Africa	17.8	22.5

Table 8.2: Trade balance (exports minus imports) in goods and services as share of GDP, SADC Member States, averages 1992-96 and 1997-2001

	1992-1996	1997-2001
	Percentages	
Non-SACU countries		
Angola	5.1	3.6
DRC	1.7	(1.3)
Malawi	(18.7)	(11.6)
Mauritius	(4.5)	(2.8)
Mozambique	(30.0)	(24.1)
Tanzania	(22.1)	(10.8)
Zambia	(6.1)	(11.4)
Zimbabwe	(3.1)	(1.2)
SACU countries		
Botswana	10.9	14.2
Lesotho (%GDP)	(95.8)	(66.2)
Lesotho (%GNDI)	(70.0)	(54.2)
Namibia	(10.9)	(12.4)
Swaziland	(22.6)	(15.7)
South Africa	2.4	2.1

With a high share of imports in GDP, not surprisingly SADC Member States with VATs show that high shares of their VAT collections are collected on imports. Table 8.3 gives the import VAT as a share of total VAT collections between 1998 and 2002 for 6 of the 8 SADC countries with VAT in place by 2002. Data was not available from Namibia and Mauritius. In recent years these ratios have typically been in the range of 50% to 70%. South Africa has been at the bottom end of the range with import VAT as a share of total VAT at or close to 50% and initial data from Botswana shows that it is at the top end of the range at about 70%, with most other countries mainly in the 50% to 60% range. Much of the import VAT will be collected on the inputs of registered traders, and hence, become input VAT deductions against the gross domestic VAT declarations, but the remainder represents final VAT collections as imports by unregistered businesses or individuals. Appendix C provides a detailed analysis of the estimation of the share of final VAT collections that are derived from import VAT.

To estimate the share of final VAT collections coming from imports, information is required on the share of import VAT that becomes an input VAT deduction by registered domestic importers. Unfortunately, this information is not known directly for most countries. Some countries break down the input VAT deductions claimed by registered VAT payers into deductions arising from VAT paid on imported inputs versus VAT paid on domestic input purchases. For example, a recent study in Ghana for 1999-2001 was able to determine that approximately 60% of the import VAT was deductible as input tax while the import VAT averaged around 70% of total VAT collections.[96] Hence, 40% of the import VAT were final VAT collections and formed about 28% of final (net) VAT receipts in Ghana.

Even though similar data is not available on the breakdown of input VAT deductions for SADC countries, it is unlikely that less than 30% or more than 70% of the import VAT will become an input VAT deduction. Hence, it is reasonable to expect that import VAT represents somewhere in the range of 15% to 50% of the final VAT taxes.[97]

This means that even at the lower end of this range, if border controls are removed and taxes are not collected at the borders, a country would be at risk of losing some 15% or more of its VAT collections that would otherwise have been collected from imports by unregistered importers.

In addition, countries would lose revenues through increased export frauds related to either falsely declared zero-rated internal exports or "round tripping" of such exports back into the home country. To deal with this situation, a number of changes could be made to the VAT structure for dealing with internal trade within a regional free trade area such a common market**.** Appendix D gives a systematic comparison of the range of tax structures applied to internal trade within a regional free trade area such as proposed for SADC. Here, the focus is on potential solutions.

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[96] Graham Glenday, "VAT analysis and revenue estimation based on micro-simulation data," a report prepared for the Ministry of Finance, Ghana, August 2003.

[97] Namibia maintains import VAT accounts for registered VAT payers to control payment, deferral and deduction of import VAT. This will allow the estimation of the share of import VAT deducted. Malawi records the amount of input VAT arising from import VAT on its VAT returns and hence the share of import VAT that is deducted could be estimated.

Table 8.3. Import VAT as a share of total VAT, selected SADC countries, 1998-2002

	Fiscal year ending in:				
	1998	1999	2000	2001	2002
			Percentages		
Botswana					70.0[p]
Malawi	60.0	64.6	68.7	60.1	56.4
Mozambique		59.3	58.6	57.5	57.1
South Africa	45.5	47.2	45.7	47.9	51.6
Tanzania		50.8	49.7	60.3	59.2
Zambia	34.0	42.1	60.0	62.8	57.9

P = preliminary estimate

8.3. Potential VAT structures on internal trade within SADC

If border controls are significantly weakened or eventually eliminated on internal trade within SADC, then there are three types of potential solution to sustain VAT revenues and maintain a system of destination-based VAT.

All of them involve:

(i) VAT being charged on internal exports, and
(ii) require some level of involvement of a regional cross-country supervisory agency sanctioned by regional treaties,

but differ on:

(i) how the revenues from internal trade would be distributed among the countries in the region and
(ii) whether or not countries are required to harmonize their VAT systems, or whether the VAT rate structures can vary across countries.

Note - All of these solutions involve removing zero rating from internal exports (or exports between member countries of the regional free trade area), but choices exist concerning the VAT rate charged on the exports and whether or how the importing country gets compensated for the VAT included in its internal imports. More detailed analysis and background to the various proposals is given in Appendix D.

a. Compensating VAT with reconciliation

It is perhaps easiest to start with the Compensating VAT or so called “CVAT” as it was derived out of the need to solve the problem of state level VATs in a federal system of government where the state governments have freedom to set differing VAT rates, but the interstate borders are free of fiscal controls.

Under the CVAT, rather than a zero rate exports, **a special or compensating VAT rate, c_o, is charged on internal exports of both goods and services made by any member country to any other member country and the revenues are paid to a regional or super national supervisory agency established by the member countries such as the SADC Secretariat**. See Figure 8.3. The rate could be set any where within the range of standard VAT rates charged in the region. Any VAT registered business in the exporting country - country A - would by default charge the standard VAT rate ($t_{o.}$), unless the purchaser is in another country within the region when c_o is payable, or outside of the free trade region**,** when the export would remain zero rated. The importing country - country B - gives the importer credit for the CVAT paid in country A on the import (if the importer is VAT registered.) The tax authority in country B receives the compensating tax from the supervisory agency and could reconcile its compensating tax receipts with the input tax deductions based on paying compensating tax claimed by its importers. Therefore, in the case of registered firms importing, the revenue collections by countries A and B are:

$R_A = c_o - c_o = 0$
$R_B = - c_o + c_o + t_{f.} = t_{f.}$

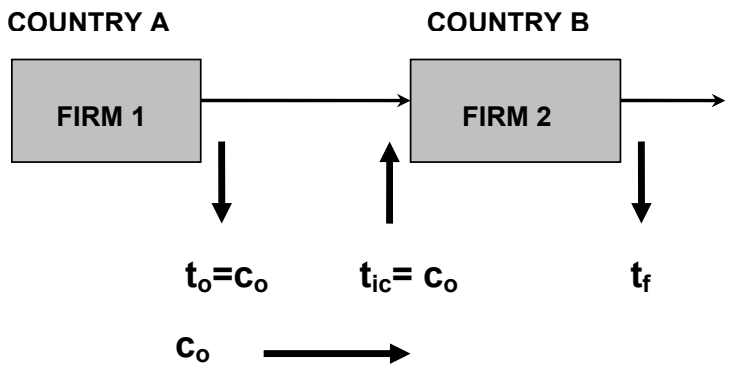
This is exactly the same outcome for a destination VAT with border controls and zero-rated internal exports

If the importer is unregistered, then the importing country may or may not capture the tax. The exporting firm in country A would pay the compensating tax to the supervisory agency if the exporting firm had information that the buyer was a resident of country B (as would be the case of a mail order or other direct shipment). The agency would then compensate country B. If the exporting firm was unaware of the location of the buyer it would charge the domestic VAT rate by default and country A would collect the domestic VAT, t_o, as a final tax on the export. In these cases, the revenue collections by countries A and B are:

$R_A = t_o$ or $c_o - c_o = 0$
$R_B = 0$ or c_o

Compared to the case of zero-rated internal exports where no tax would be collected by either country on goods and service exported to unregistered businesses in other member countries, with the compensating tax in place the importing country the importing country collects c_o where the location of the importer is known (this tax may be higher or lower than its standard rate) and the exporting country collects is own rate where the location within the region is not known.

Fig 8.3. Compensating VAT on internal exports with reconciliation



An alternative approach to reconciliation is to have the tax authorities in all member countries collect the compensating tax on internal exports and report both internal export transactions and VAT input tax claims based on compensating tax payments by registered importers to the supervisory agency. Given internal trade flows in both directions, the supervisory agency would then calculate the balancing payments that would need to be made between pairs of countries that would equal the difference between the gross flows of compensating tax that would have others occurred through the supervisory agency. At a minimum each country would want to ensure it collected compensating tax to cover the input deduction claims of its registered importers based on payment of compensating tax.

As already noted, the uniform compensating tax rate could be set anywhere within the range of standard rates of the member countries, which currently range from 10% to 20% in SADC. The greater the dispersion in the rates in the region, the larger the possible differences between t_o and c_o. These differences can be expected to result in misdeclarations of internal trade with unregistered importers.

- If $t_o < c_o$, then the importer will attempt to appear to be a domestic buyer to get the lower rate to the detriment of the revenues of the importing country, and
- if $c_o < t_o$, then domestic buyers will have an incentive to appear to be from another member country.

Suppliers would need to create false shipping documents to justify charging the wrong rate. It is clear, however, that the smaller the spread in rates the smaller the problem.

To remove the problem of the registered supplier having to make the decision on whether or not to charge the default rate on a domestic sale compared to the compensating tax rate on internal exports and zero rate on exports outside of the region, the system can be run by each member country charging its standard rate on internal exports, that is, $c_o = t_o$.

This transfers the problem of dealing with multiple rates to the registered importer, where now $t_{ic} = t_o$ and t_o will vary by the country of origin of the import, and to the reconciliation process by the supervisory agency where importers will be paying VAT at the different rates of the exporting countries. Unregistered importers will also have an incentive to import from the lower rate countries, all else being equal. Having a uniform compensating tax simplifies the calculation of input VAT deductions and the reconciliation amounts. If tax is to be charged at the rate of the country of origin of the internal export, then consideration can be given to the next option based on the origin principle of charging VAT for internal trade.

b. Origin principal on internal trade, but no reconciliation

Under this approach, the **destination** principle is applied to external trade (exports are zero-rated and imports taxed), but the **origin** principle is applied to internal trade (internal exports are taxed.) Taken as a whole, the region would be applying VAT using the destination principle on a consumption base, but the distribution of the revenues would not follow the distribution of final consumption across member countries. Under this approach member countries could have different standard VAT rates.

Under the origin principle, exports are taxed. Under the credit-method, this export VAT should be credited against any subsequent VAT to prevent tax stacking prior to the final sale. The importing country, however, will have difficulty in verifying the VAT paid on the imported inputs without special arrangements. As a result, the import country has to resort to crediting the registered firm with a notional input VAT, possibly equal to the standard VAT that would have been paid on the import. The firm then credits this "input tax" against its output VAT. With an international treaty and a supervisory agency, the exporter could supply copies of tax-paid invoices to the importing firm 2 and country B could have the right to request confirmation of the VAT paid from country A and then give a credit for this VAT, or $t_{ic} = t_o$ exactly. See Figure 8.4. This crediting process by the importing country does not depend upon border controls. The importing country then collects VAT from the stages of production within its borders. If the importer is unregistered, no further VAT is collected in the importing country (country B) as if this is final consumption.

If the importer is registered, the revenues collected by countries A and B are given by:

$$R_A = t_o$$
$$R_B = - t_{ic} + t_f.$$
$$R_A + R_B = t_o - t_{ic} + t_f$$
$$= t_f, \text{ if } t_{ic} = t_o$$

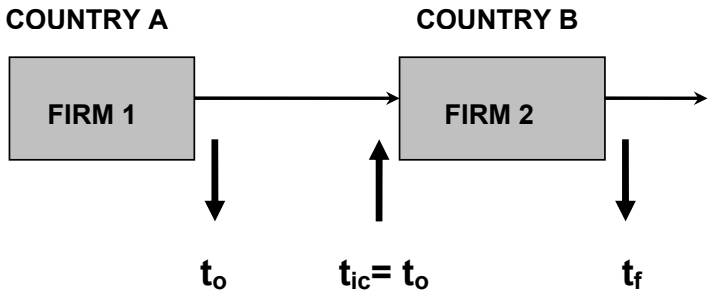
If the importer is unregistered, then the revenue collections are:

$$R_A = t_o$$
$$R_B = 0.$$

In the case of the registered importer, the total tax is the same final tax that would be collected under the destination principle, but now the distribution of revenues depends

upon the distribution of the valued added in production of the consumed good or service. In the case of the unregistered importer, tax is collected in the exporting country. To the extent that VAT rates differ across countries, unregistered importers will also have an incentive to import from the lower rate countries, all else being equal. This will bias production in the region towards countries with lower VAT rates.

Fig 8.4. VAT on internal exports: origin principle and regional supervision



An origin tax can effectively be collected from all registered traders on all supplies (including services and distance sales to persons in other member countries) at the point of sale rather than at the point of export. Internal exports by unregistered traders would be missed without border collection of the export VAT, but this is usually less of a problem in that exporters are typically the larger businesses in an economy. Note that tax will be collected at least at the tax rate of the exporting country on all taxable supplies, no mater whether they are supplied to a registered or unregistered persons or are services or distance sales.

This option results in the VAT falling on consumption within the common market, but the VAT revenues collected may *not* be distributed among the countries according to consumption within the countries as the VAT charged on internal exports is retained in the exporting country **unless some compensatory payments are made between the countries or an alternative revenue sharing arrangement is made**.

Origin taxation of the internal trade makes the distribution of the revenues favor the countries with a higher share of the taxable production (net internal exports) rather than taxable consumption (net internal imports).[98] In the case of SADC, countries with net internal export balances would gain VAT revenues such as South Africa at the expense of most other SADC Member States with net internal import balances.

[98] With origin taxation internally and destination taxation externally, unusual distributions of VAT could arise depending upon the trade balances of countries internally and externally. A country that is a net external importer, but a net internal exporter would gain a disproportionately high share of the total revenues of all member countries. By contrast, a country that was a net external exporter, but net internal importer would receive a disproportionately low share of the total revenues.

The bias for unregistered importers to purchase from the lower VAT rate countries could exacerbate these trade imbalances within SADC. Hence, while application of the origin principle with regional supervision and administrative co-operation solves the loss of VAT revenues on imports by unregistered importers from the relaxation of border controls and improves the taxation of trade in services and of distance sales, the distribution of revenues within the SADC region may not be acceptable. Hence, an approach that retains the benefits of origin taxation in revenue collection needs to be combined with a different approach to revenue sharing across the region.

c. Origin principal on internal trade, with revenue pooling and consumption based sharing

This approach retains the destination principle for external (outside the common market) trade, and origin principle for internal trade, but pools **all the VAT** collections from all the member countries. The revenue pool is then shared in proportion to estimates of consumption (or some more accurate estimate of the value of the VAT base) of each member country. This requires

(i) a supervisory agency to manage the revenue pool and
(ii) a common tax structure be applied across all countries.[99]

Without a common VAT structure, countries with broader bases and higher VAT rates will be transferring revenues to those with narrower bases and lower VAT rates. To allow for some variation in standard VAT rates, the consumption base of each country could be weighted by its standard VAT rate, or instead of estimated consumption bases being used to share revenues, estimated consumption taxes would be used as weights. This approach has been suggested for the European Union VAT system[100] and will be applied under the new SACU Agreement for the collection of excise duties using the GDP of the SACU member countries as the sharing basis. In general, the approach of collective or pooled collection avoids the issues of any revenue gaps at the internal borders, and the sharing in proportion to the estimated consumption bases or collections allows the countries to retain their revenue bases. This approach is analogous to a nation-state collection of a destination-based VAT and then sharing the revenues across sub-national political units according to consumption shares.

The revenue pooling and sharing approach has some concerns that need to be addressed.

- First, concerns arise about whether the incentives of the tax administrations of individual countries to collect revenues are undermined by the pooling process.

[99] Complete harmonization of tax structures is not essential, but the basic features of the tax structure that change the effective VAT rate on tradable goods and services or affect any incentives to invest across countries should be harmonized. The tax rates, zero rates and exemptions affecting the cost of tradable goods and services need to harmonized. The real level of turnover for compulsory registration and the VAT treatment of local public sector-type services could be subject to some degree of variation across countries.

[100] Commission of the European Communities, "A Common System of VAT: A Programme for the Single Market," COM(96) 328, July 1996.

- Second, as can be noted from Chapter 6, there is a wide variation in tax efficiencies across countries that can make revenue sharing across countries of a relatively large revenue source such as VAT problematic on the basis of any macroeconomic aggregate such as GNDI, GDP or consumption. Without adjusting for tax efficiency, the more inefficient countries will receive a larger share than they deserve.

Two approaches to combined retention and pool sharing are explored in Appendix E.

- The first approach uses partial retention and sharing of the residual pool in proportion to a member country's share of consumption. For example, member countries could retain share of their own collections (say, two-thirds) and deposit the remainder in a central pool for sharing amongst member countries based on estimates of consumption. This approach leaves member countries with incentives to collect, partially adjusts for the VAT efficiency, and reduces concerns about the timing of receiving funds back from a central pool. As the retention gets higher, concerns would arise about the allocation of taxes collected on imports from outside of the common market arriving and being collected in one country while they are destined for another member country. This would require the allocation of retained taxes on such imports to the destination country to which the goods are assigned.

- The second approach has countries that are net internal importers from the other member countries retain all their collections, while the net exporting countries retain a share of their collections that removes the estimated share of revenues derived from net exports to the other member countries. The remainder of the collections by the net exports would be deposited in a central pool and shared amongst the countries with net imports from the other member countries in proportion to their share of total net internal imports by the net importing countries. While the allocations across countries would be precise and avoid the issues of different collection incentives and VAT efficiencies across countries, it leaves the concern that measures of internal trade between member countries would need to be retained. This may require the use of border controls. The problem of customs collection of imports by one country destined to another member country is handled through the mechanism of adjustments based on net internal exports and imports between member countries.

8.4 Future Directions for SADC

The approach of origin-based collection internally, and pooling and sharing revenues may be taken as a medium term target, but is not attainable in the short term given the significant differences in the consumption taxes structures and bases across SADC Member States aside from the need to build the revenue pooling and sharing legal and institutional structures. Currently, 10 of the 13 SADC members have VATs, some of a very recent origin. Focusing more on the current situation, all member countries still maintain fiscal border controls, hence the development of any co-ordinated VAT collection can utilize these facilities. As shown in Appendix D (section I.A (iii) and (iv)), however, the CVAT (or compensating VAT) and/or the charging of domestic

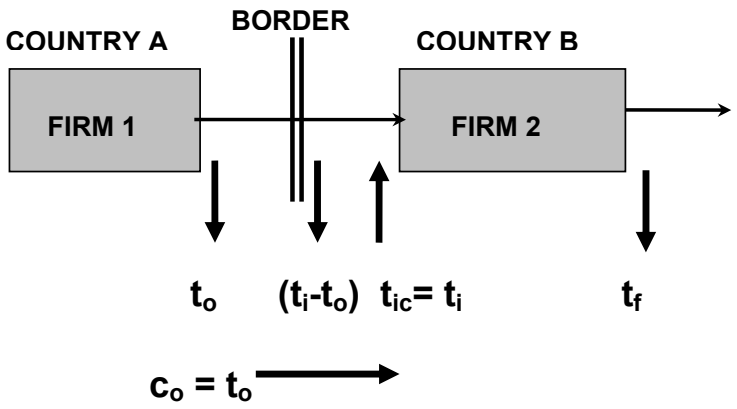
VAT on internal exports (along with registered importers getting input VAT credits for taxes paid in the exporting country and the import country getting compensated for providing these credits can be applied) can be implemented with border controls in place. In fact, with border controls in place the importance of having more similar sales tax or VAT systems is diminished because differences in tax treatment can be resolved in the border transactions.

This resolution of different tax structures can be illustrated using Figure 8.5 where VAT is charged on internal exports (either at the domestic VAT rate of t_o in country A or at the compensating rate of c_o if a CVAT is in place), the importing country B charges (or credits) the difference between its import VAT rate and the exporting country rate ($t_i - t_o$) and then allows its import VAT rate to be taken as an input VAT deduction if the importer is VAT registered against output VAT (t_f).

Country B claims compensation of $c_o = t_o$ from country A through a supervisory agency for crediting the VAT rate of country A. Clearly if both countries have the same standard VAT rate, the border resolution simplifies ($t_i - t_o = 0$), but in principle the tax differential could be collected or credited at the border if the rates differ. If country B had a single stage sales tax instead of a credit-method VAT that exempted tax on capital and intermediate inputs into the production of taxable supplies, then $t_i = 0$, but the registered importing business would receive a full credit of t_o, the tax paid in country A.

It is further noted that some of the features of an overall consumption tax system already exist within SACU. SACU already has revenue pooling and sharing for import and excise duties within common tax structures with a supervisory agency in place (though it is currently undergoing reforms under the 2002 SACU Agreement.) Within SACU, the issues of weakened border controls have already emerged and bilateral agreements are being pursued and implemented, such as between South Africa and Lesotho, to resolve these problems.

Fig 8.5. VAT on internal exports with reconciliation



This analysis suggests approaches to develop a regional consumption tax structure.

- The early stages would involve the establishment of a CVAT with a reconciliation arrangement. This could be initially tested either within SACU or across a subset of SADC countries. This tax-and-compensate mechanism is already being used on trade between South Africa and Lesotho. This structure could then be rolled out to all SADC Member States such that internal exports are subject to tax at either the domestic VAT rate or a CVAT rate by the time a customs union is in place in 2010, or later, by 2015, the target for a SADC common market. Agreements could also be reached about the degree of harmonization of VAT structures and rates within the SADC region to allow revenue sharing based on estimated consumption tax bases or collections. This would allow a switch from revenue reconciliation to revenue pooling and sharing once the legal and institutional arrangements exist for managing a SADC revenue pool.

- Another early initiative that should be undertaken is an effort to confirm the share of import VAT that is a final tax across countries or alternatively the share of final taxes that are derived from import VAT. Data to available to date suggest that some 15% to 40% of final VAT could be collected at the border. This represents a significant share of VAT revenues that could be at risk. A high rate of final tax collection on imports forms a fundamental motivation for changing the VAT treatment of internal trade from destination to origin based within a customs union or common market where fiscal borders are weakened or eliminated. Unfortunately, direct evidence is not available from SADC Member States. Countries should therefore be encouraged to collect and report the following:

  i. Import VAT or VAT collected at the border by customs each fiscal year. While these records are available to the VAT authorities of all countries, all countries do not systematically report them.

  ii. Import VAT collected from registered and unregistered importers. This requires either self-declaration by the importer of his VAT registration status on import documents and/or the matching of importer identification numbers (usually a taxpayer identification number) with records of businesses registered for VAT.

  iii. Total input VAT deductions and the amount of these based on import VAT paid in a fiscal year. This requires domestic VAT returns to split input VAT deductions into those arising from import VAT paid and those arise from VAT invoices from domestic suppliers.

IX. VAT administration: organization, operations and development

The performance of a tax system depends critically on many structural features of an economy. These issues were discussed at some length in Chapter VI in terms of the tax capacity, effort and efficiency of the member countries. Two critical components of any tax system are the capacity of the taxpayer to comply with the tax law and the capacity of the tax administration to assist the taxpayer to comply as well as enforce compliance where it is not voluntarily forthcoming. The credit-method VAT is a self-assessed tax which puts a large burden on the taxpayer in terms of appropriately issuing VAT-invoices, maintaining books and records, collecting VAT, filing returns and making payments to the authorities. The success of a VAT, therefore, depends critically on the capacities of the taxpayers. The focus in this Chapter, however, is on the capacities of the tax administrations to facilitate and enforce a VAT.

The primary source of information on the tax administration capacities of SADC Member States is a survey on tax administration organization and operations, with a focus on VAT, general sales or turnover tax administration, in order to determine its status and the need and scope for development of the administrative capacity.

All thirteen SADC Member States provided answers to the questionnaire. The survey was largely self-administered, but David Hollinrake, SADC Tax Advisor, also visited nearly all of the countries and interviewed the tax authorities, and assisted where possible with obtaining answers to the survey. The author, Graham Glenday, also visited or worked with the tax authorities in six of the member countries in the context of this or other projects. A copy of the questionnaire that was administered is provided in Appendix F and a listing of the meetings with officials in Member States is provided in Appendix G.

The results of the survey are tabulated at the end of this Chapter as Table 9.1.

9.1 Organization and management of tax administration

Organization of tax administration
Three aspects of the broad organization of tax administration were focused on:

(i) whether the tax administration was organized as a separate revenue authority and the degree of autonomy of the administration;
(ii) whether the administration was organized on a tax-type or functional basis and
(iii) whether a large taxpayer unit had been established.

Seven of the thirteen member countries (Botswana, Lesotho, Malawi, South Africa, Tanzania, Zambia and Zimbabwe) have established over the past decade semi-autonomous revenue authorities to administer taxes. Mauritius and Mozambique have revenue authorities under preparation and Swaziland has one under consideration with expected implementation in August 2006. Where revenue authorities are not in place, taxes are administered by departments of the Ministry of Finance and the tax officials

are appointed under the general public or civil service arrangements. In most cases, where revenue authorities exist, boards of directors, which have varying degrees of private sector representation, makes appointments, other than the Commissioner General. In one case, Botswana reports that appointments are still made under the public service laws, rather than independently by the authority (as an interim measure). In the case of the DRC, the revenue department reports a high degree of autonomy in administrative and financial matters of tax administration.

Functional organization of the administration of inland revenue (or the collection of any type of tax revenue from domestic taxpayers) has become a common trend internationally. A functional organization is based on managers overseeing one tax administration function (for example, revenue collection) for all types of tax. This contrasts with tax-type organization where one manager oversees all functions for one type of tax. The move towards functional organization seeks administrative cost-savings, higher revenue yields and less compliance burden of the taxpayer through the synergies of simultaneous audits and collections of all types of tax from a taxpayer.

Most countries with an Anglo-tax tradition have tax type organizations. This is true for all the nine SADC Member States with strong Anglo influences on the development of their tax systems, except for South Africa, and Zimbabwe, which have shifted to functional organizations as part of establishing their revenue authorities. These countries also often followed the Anglo-tradition of placing VAT or sales taxes under their Customs and Excise administrations. This is still true in Botswana and Swaziland.

Countries with tax traditions derived from continental Europe tend to have inland revenue organized on functional lines. This is the case in Angola, DRC and Mozambique. Mauritius has a tax type organization. Overall only six of the thirteen member countries are fully or largely functionally organized. Zambia has its debt collections, and large business and investigations organized on a functional basis but broadly retains tax type administration. Mauritius along with establishing a revenue authority is also reorganizing its tax administration along functional lines.

Where revenue authorities have been established there is always some degree of centralization or co-ordination of many high-level functions (policy and planning, legal services, and internal investigation, as examples) and support functions (such as human resources, information technology and finance). Key tax administration functions of audit and collection typically remain separate, however, if the authority has a tax-type organizational structure.

Another trend that is emerging in tax administration is the development of client-oriented tax administration. The focus here is recognizing that taxpayers in different sectors or of different sizes may require different services, compliance strategies and have different revenue importance. A client-oriented structure involves having functionally organized units focus on different market segments. The most common example is the large taxpayer unit or LTU, where large taxpayers, typically identified by having a high turnover level, have a one-stop relationship with the revenue administration. Typically assessment, audit, collection and service functions are provided by one-unit for all tax types. Clearly, the formation of LTU would be easier in the context of a functional organization, but interestingly LTU's exist in tax-type

organizations as commonly as functional organizations. Overall, seven Member States report establishing LTUs – four amongst the functionally organized administrations (Angola, DRC, Mozambique, and Namibia) and three amongst tax-type administrations (Malawi, Mauritius and Tanzania). South Africa reported an LTU was under consideration. It is now introduced. Two countries (Lesotho and Zambia) also report having large trader units within VAT and/or income tax administrations.

Budgeting for and costs of tax administration

The questionnaire sought budget allocation to tax administration in total and by inputs (personnel, capital, other current) and by type of tax in order to check the transparency of tax administration budgeting and the potential use of the unit costs of collections as revenue performance measures.

Eleven of the member countries have a budget allocated by the Ministry of Finance that is negotiated annually. Two have their budget set as a share of collections: DRC (7%), and Lesotho (2%).

Only five countries (Botswana, Mauritius, Namibia, South Africa and Swaziland) reported the costs of tax administration broken down by input types and Lesotho reported the total cost. Namibia and South Africa could not break down the costs by tax-type. This is understandable where functional tax administration is being used such as in South Africa.

Client market

The questionnaire requested information on the taxpayer population in terms of numbers registered, numbers active taxpayers and size distribution of registered taxpayers in order to determine how aware the administrations are of the characteristics of their client population and whether it is possible that this information was being used to direct administrative resources to improve the efficiency of collections.

All but two could provide a count of the number of registered VAT, sales or turnover taxpayers. Zimbabwe could not provide further details as its VAT was in start-up phase. Angola could not separate out the turnover taxpayers from all registered taxpayers. Out of the remaining eleven countries, nine could give estimates of the active taxpayer population, but only six could provide a distribution of the registered taxpayers by turnover.

Staffing, qualifications, pay and training

All countries except Zimbabwe (new organization) and Mozambique supplied information on the number of tax administration personnel involved in the VAT, sales or turnover tax administration. While there is difficulty in the comparability of the data because of different organizational arrangements, particularly functional versus tax-type organizations, there is a wide range in the number of taxpayers per tax official.

At the low end, with less than 40 taxpayers per official are Lesotho, Malawi, Swaziland and Tanzania and officers are administering only one type of major tax.

In the mid-range are Mauritius (40), Botswana (69), and South Africa (84). Namibia has 341 taxpayers per officer, and Angola has 5,628 taxpayers (including individuals) per officer or 649 corporate taxpayers per officer. In the cases of South Africa, Namibia and Angola officers are administering all inland revenues. Having too few tax officers can be inefficient as the tax may neither be effectively enforced nor the taxpayer properly serviced, but equally having too many tax officers is wasteful of resources. This is likely to be the case in the countries with below 40 taxpayers per officer managing a single tax. Angola, by contrast would appear to have too few tax officers, but closer analysis of Namibia would be required to determine whether the staffing was appropriate.

Tax administration requires a range of high skills including management, law, accounting, auditing, information technology etc. Ideally, a high proportion of tax officers should have post-secondary education at the university or other professional certification level plus considerably job specific skill training. While there are difficulties in making comparisons across different organizational structures, generally many countries appear to have shortages of high qualification staff.

Mozambique did not report any estimates of qualifications of staff. Four countries report having less than 20% of their staff with post-secondary university or other professional certification: Angola, DRC, Malawi and Namibia. Four report between 20% and 40% of their staff with such qualifications: Botswana, Mauritius, South Africa and Swaziland. Four report having over 40% of highly qualified staff: Lesotho, Tanzania, Zambia and Zimbabwe, but their estimates may be over stated by underreporting the share of centrally employed support staff that are actually servicing VAT administration. All countries report acute shortages of qualified accountants – typically well below 5% of the officers.

No systematic pattern emerges from reports of vacancies. When reviewing the competitiveness of wages offered by the tax administrations with the private sector, a clearer pattern emerges that the revenue authorities operating outside of the restrictions of the civil service pay scales, are able to offer more competitive pay packages than the departmental administrations. Even amongst the revenue authorities, however, problems emerge in retaining or attracting highly qualified personnel such as fully qualified accountants.

Overall, while the implementation of revenue authorities has improved the ability of tax administrations to retain and attract qualified personnel, there remain issues of the adequacy of the skill levels of staff and the need to develop internally or attract top-level professional and managerial staff. Tanzania reports the use of performance-based term contracts for top managers. Further investigation into the use and effectiveness of such contracts may be fruitful. The problems of inadequately qualified staff are more acute among the tax administrations that cannot offer competitive pay. The traditional trade-off between over-employment of lower skilled personnel and raising the pay levels of top employees to attract or retain them persists.

All member countries, except DRC, report having some forms of internal training capacity, ranging from a small unit to a more formal training institution. DRC only uses external training capacity. The internal training capacity is typically geared to training new recruits in VAT or sales tax law and administration. Many offer various

more advanced courses or refresher courses. About a third mentions audit related training. Other skills training in areas, such as management or information technology, are only mentioned by a few countries, such as Zambia and Mauritius. Given the high fixed costs of developing and maintaining training capacities, it is not surprising that the poorer and smaller countries typically have more limited training capacities and limited funds to make use of regional and external training opportunities. Most countries report use of regional training opportunities such as those offered by SADC and the Southern Africa Tax Institute (SATI) that is based in South Africa. Angola, DRC and Mozambique all note the difficulties of accessing regional training opportunities because of language and financial limitations.

Most of the countries report making use of training opportunities abroad in Australia, France and the US to the extent that funds are available.

Clearly, the building of capacities in tax administrations represents a major long-term challenge for SADC. Much of the capacity will need to be internally generated, but some can be achieved through changes in pay policies to attract and retain top quality staff. Training strategies will need to be at the core of moves towards functional administration (officers will need to be trained in all the major domestic or inland taxes), greater use of information technology, especially e-government, enhanced audit performance and improved taxpayer service. Tax officers will need broader access to training in "non-traditional" areas such general management, public relations, information technology as well as more traditional areas such law, accounting and auditing.

There are clearly economies of scale in training that can be accessed on a regional basis. The ability to conduct all training regionally is limited by issues such as language, and differences in the laws and specific procedures of the Member States. Regional and international training is usually better suited to higher level training and more general skills such as accounting, management, information technology, tax analysis and revenue forecasting. Such training can be used for leadership training as well as the training of trainers. Moves to harmonize laws and administration across SADC Member States, however, would expand the range of training opportunities that could be offered on a regional basis or at least amongst groups of countries with the same working language and similar tax and economic structures.

Computerization

The degrees of computerization of tax administration cover a wide range. In the area of customs administration, Angola and Mozambique do not provide information. Botswana and Mauritius report having high degrees of computerization of customs clearances and administration. At the other extreme, Lesotho and Swaziland only have computerized customs and trade statistics. In between these, the other member countries report systems (such as Asycuda) that are either run in parallel to paper systems or may have partial computerization of some customs functions and varying degrees of integration with the administration of other taxes such as the use of common taxpayer registries.

In the area of domestic administration of VAT, sales or turnover taxes, the degree of computerization is typically less than for customs. A number of countries report a high degree of computerization and reliance on computer records (though paper

returns and correspondence records are maintained.) These include Mauritius, South Africa, Zambia and Zimbabwe. A number are maintaining parallel paper and computer systems (such as VIPS). These are Botswana, DRC, Lesotho, Malawi, Mozambique and Namibia. Swaziland report limited use for capturing returns information and collection statistics, while Angola only reports using computers in maintaining collection statistics.

Clearly, in SADC considerable scope exists for strengthening the use of computer-based administration in VAT, sales and turnover taxes both at the borders and inland.

With the rapid growth of internet services based on the World Wide Web and related e-governance techniques, the importance of comprehensive and integrated tax administration systems is growing. The internet not only provides a powerful and cost-effective means of communicating with the tax paying public by making tax compliance information rapidly and widely available (as will be discussed further below under taxpayer education), but also opens the door to the electronic receipt of both tax return information and tax collections.

Effective internal computer systems need to be in place to receive and process this tax information and account for the tax receipts. Moreover, the internet has greatly "democratized" information technology. It is making powerful computer-based information and data processing tools widely available, in user-friendly ways and at relatively low costs. Internet cafes are offering low cost access to the power of the internet and are becoming available in most urban centers where the bulk of taxpayers are located. E-filing and e-payments of taxes are dramatically lowering the costs of tax administration and, more importantly, of tax compliance. At the same time offering enormously expanded, more timely and more accurate information bases to tax administrators and tax policy analysts. Many countries are either encouraging or even requiring the e-filing of tax return information on a selective or more general basis e.g. for the largest taxpayers. In some countries, e-filing will include tax calculators to ensure accurate tax calculations as well as e-payment mechanism of tax liabilities. This cost-effective potential of e-government in tax administration needs to be exploited by SADC Member States. The capabilities of member countries are noted under taxpayer education and service below.

Tax administration functions

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Audit capacity

With any self-assessed tax such as the VAT, audits, especially field audits, are a critical tool in controlling the accuracy of tax returns. The effectiveness of any audit program depends critically on three factors.

- First, the audit program or the basis of selection of businesses for a tax audit: which businesses have a high probability of having underreported their tax liability by a large amount.
- Second, the quality of the auditors determines their ability to detect or identify underreporting of taxes.
- Third, the mechanisms used to control quality and preventing corruption.

The second factor, the quality of the auditors, is dealt with under the section on staffing and training, which notes a shortage of fully qualified accountants in most of the tax administrations, but recognizes many countries provide training in the area of tax accounting and auditing. The other two factors are the focus here.

Most countries report routine field audits ranging from once a year to once every five years. Some countries distinguish between visits and more in-depth investigation, and between the levels of effort devoted to small versus large businesses. Namibia reports random risk-weighted selection. South Africa reports grouping firms into three groups – high, medium and low – resulting in visits every 3, 4 or 5 years. Swaziland uses past records and subjective judgment to risk classify firms to determine the frequency of audits. Tanzania uses size to determine the same three classes of frequency of visits – large firms being visited more frequently than small. It also report that the computer system does assign points to identify high risk companies, but generally manual selection is used. Malawi requires audits of all firms claiming refunds. Zambia reports a combined system of computer-based, intelligence based, subjective judgments and past audit result-based risk assessment and selection.

There is clearly much scope for developing objective risk-based selection of audits and especially with regard to refund audits that appear to take a disproportionately high level of resource in many countries. This requires the development over time of computer-based track records to identify key determinants of high-risk taxpayers.

Audits can be risky in the sense that they open up opportunities for improper negotiations between the auditor and taxpayer. To control audits, many countries report field audits being conducted in pairs and audit reports being scrutinized by a supervisory or some higher-level officer. A few countries report the use of internal audits or follow-up audits either randomly or intelligence-advised as well as checks on audit reports. A few countries report no mechanism for oversight of audits.

Debt collection capacity

All countries, except DRC, report having some type of special units dedicated to debt collections. In the six countries with functional organizations, these units collect taxes from all types of domestic taxes. In addition, Zambia reports that its debt unit services all types of tax even though it has a tax-type organization. The remaining six countries organized by tax type have separate collection units for each tax type. In DRC, it appears that debt collections are conducted by an external organization. Seven countries report the size of their dedicated debt collection units, varying from 4 in Botswana dedicated to VAT up to 28 in Zambia with a combined tax collection unit.

Most countries have similar debt collection powers. Typically penalties and interest are charged on outstanding taxes and demand notices are issued to defaulting taxpayers. Most countries report the ability to attach and auction property (land, buildings and other real assets), many can attach or freeze bank accounts, and some can garnish wages or sequester rental or other income flows. In most cases, the tax authorities are empowered to undertake collection enforcement actions. Angola and DRC appear to have external agencies to enforce debt collections.

Enforcement and appeals
Generally tax enforcement is carried out through administrative procedures. Only South Africa report actual prosecution of tax fraud cases, while Lesotho, Zambia and Tanzania report cases under preparation.

All countries report layered mechanisms for the taxpayer to appeal agency-made assessments, penalties etc. In general appeals can be made to the tax administration to a senior official or the highest-level officer in the administration. A few countries (Lesotho, Malawi and Tanzania) report internal committees to review appeals rather than delegating the task to the top officer. Only Angola and Swaziland report that appeals can be made to the Minister for Finance. Many countries have established some special tax tribunal, board or court as the first level of external appeal. These include Botswana, Lesotho, Mauritius, South Africa, Tanzania, Zambia and Zimbabwe. Malawi and Namibia report their intention to introduce such bodies. These specialized "courts" tend to be the major bodies for most VAT appeals. South Africa has also introduced an "Alternative Dispute Resolution" mechanism, though the range of issues that can be negotiated rather than determined on the facts of a case are unclear. In most countries, appeals can be taken to the high courts, though this is generally uncommon for appeals on assessments under an indirect tax such as VAT, sales or turnover tax in unless there is some fundamental issue of legal interpretation. In Angola and Mozambique, the administrative courts are the highest level of appeal, but as is pointed out in many situations the senior tax administrators are also members of administrative courts.

Taxpayer education and service
VAT is a self-assessed tax that puts the bulk of the burden of administration of the tax on the registered taxpayer. The cost-effective education and service of taxpayers can lower the costs of compliance and improve the quality of compliance. All countries report using various media and strategies for educating and communicating tax compliance information.

Most countries use some combination of the following:

- visits to taxpayer (particularly upon first registration or audit),
- workshops,
- public rallies,
- help desks at local offices,
- central information call centers with toll-free telephone lines,

And distribute information through a range of media including:

- official publications (government gazette),
- pamphlets and guides,
- public newspapers,
- radio and TV advertisements or discussion programs,
- special tax newspapers or journals,
- and various uses of internet services.

As noted above, under computerization capacities, internet services offer powerful cost-effective means for disseminating large amounts of information rapidly. The use of the internet as a media varies across countries. South Africa and Mauritius have websites that provide full services of publishing documents (budget speeches and documents, laws, regulations, rulings, guidelines, etc), e-filing and e-payment of taxes. Many countries have websites that provide full publication of documents. These include Botswana, Lesotho, Tanzania, Zambia and Zimbabwe. Other countries have websites with limited summary and descriptive information about the tax agencies and taxes. These include Angola, Namibia and Swaziland. Namibia is preparing to launch a more capable website. DRC tax authorities do not appear to have a website, but report using email to communicate with taxpayers, as does Lesotho.

Some countries such as South Africa have implemented policies of rapid or immediate publication of all key public documents (laws, regulations, policy announcements, etc) to ensure rapid and comprehensive access to public information. In the case of a tax system such as the VAT, e-publication and even e-mail provide a powerful tool for rapid and accurate dissemination of technical information such as changes in rate or exemption schedules, effective dates of application of changes, etc as well as softer information such as encouraging good citizenship by taxpayers. Any information that can be published in printed media can also be published through the internet.

Clearly, the results of the survey indicate a wide range of channels being used to communicate with taxpayers. The effectiveness of the messages and the ready access to accurate and timely information about tax compliance is difficult to judge from some of the survey responses. For example, the quality of pamphlets and how widely are they distributed and in what languages. In some cases it is clear that every registered taxpayer is sent a copy, but in others a pamphlet may have a limited numbers printed or only be available in limited locations.

Ultimately, there is a need to survey taxpayers as to the effectiveness of taxpayer education and services – such as how much do they know, how quickly and cheaply do they find out about changes in tax compliance and how difficult or costly is it for them to comply.

Tax performance statistics

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The questions on tax collection statistics were designed to assess the availability (and hence potential use in tax policy and administration functions) of various collection measures.

The first group of questions, about the amounts of VAT, sales tax or turnover tax collected at the border compared to domestic transactions, was motivated by the concerns raised earlier in the report about the importance of collections at the border and the issues this raises in the context of establishing a common market. Customs plays critical roles in collecting taxes on imports by unregistered persons as well as controlling export frauds that have to be overcome in moving to a common market.

The second set of questions checks on the availability of data that are important management information in directing tax enforcement efforts as well as in forecasting tax collections. This information focused on collections of arrears and payments of outstanding refunds.

Table 9.1 shows that only 7 of the SADC Member States are able to report VAT, sales or turnover collections at the border: Botswana, Malawi, Mauritius, South Africa, Tanzania, Zambia and Zimbabwe. These countries plus Namibia also reported collections from domestic transactions. The other countries cannot separate out the source of their revenue collections.

Somewhat fewer countries were able to report statistics on arrears and unpaid refunds. Botswana, Mauritius, South Africa, Tanzania, and Zambia reported data on the amounts of arrears and the periods of delay in collections. In the case of Zimbabwe given the newness of the VAT, arrears and refund data was not yet available. Only three countries report the share of arrears arising from parastatal companies that are typically more difficult to collect. Mauritius reported the important distinction between arrears arising from self-assessments and those from agency assessment, the latter being typically more difficult to collect. In addition, Malawi reports the aggregate breakdown of arrears between parastatal and private companies based on manually maintained records. Only Mauritius and Zambia report the amounts of unpaid refunds at year ends. (For the three countries that do not have a VAT, credit refunds are not an issue.)

Finally, out of the twelve countries excluding Zimbabwe, only four reported the amounts of taxes collected from enforcement actions (as opposed to payments arising from self-assessments): Botswana, Mauritius, South Africa and Zambia. The amounts and sources of taxes, penalties and interest payments is important source of management information in directing enforcement activities (particularly tax audits) as well as in making revenue forecasts.

Overall, while most countries report having parallel computer systems to maintain collection statistics, it is evident that most are not maintaining or using this data in a fashion that would assist tax enforcement and revenue forecasting.

9.4 Interpretation issues

Some caution should be used in interpreting the results of the survey. It has to be recognized that in some cases where no information was provided, that the information may nevertheless exist in some office of a government to which the official assigned to respond may not have access. Even in such cases, however, lack of a response indicates that the information is not readily available or being commonly used in the management of the tax. The ineffective use of information is an issue in itself.

Another area of caution arises out of the comparability of some measures such as costs of administration and numbers and quality of staff. The problem clearly arises from two sources. One is the administrations that are organized on a functional basis

have difficulty in allocation staff and costs to the VAT, sales or turnover tax. The other is in administrations with revenue authorities providing centralized common support services, there is also a problem of recognizing and allocating these costs to a particular tax. These concerns will be recognized as supporting a recommendation that future research aimed at assessing and improving tax administration should be conducted on a comprehensive tax-system basis rather than a tax type basis to assess staffing and financial resource adequacy and allocations.

9.5 Summary and conclusions

Not unexpectedly, given the diversity of the income levels and other economic structural and cultural differences among the SADC Member States, there is a wide range of administrative capacities in the region to support VAT implementation. At the same time, considerable and significant reforms of tax systems have been undertaken, and in many cases, are still being undertaken or implemented. The development of tax administrations is an ongoing endeavor. While some member countries have achieved a high level of sophistication and efficiency in tax administration, no country can claim to have achieved and implemented "best practices" in all areas of tax administration. In all countries, the efficiency of tax administration is not just limited by internal administrative capacities, but often more importantly by the limited capacities of the economically active population to comply with taxes.

A number potential areas for action based on the survey findings are already outlined above. This cross-country comparison, however, cannot reveal the detail of the flaws in tax system design or implementation in each individual country. That would require a considerably more thorough and detailed analysis of the tax systems in each country than undertaken here. This study can serve, however, to sensitize administrators across the SADC Member States to the different approaches being taken across the region that may stimulate follow-up reviews and actions in their own countries. Beyond that, this attempt is made to highlight some issues and areas that will be important in moving towards a common market, improving tax co-ordination, and most importantly, in encouraging and providing co-operation in tax administration that will provide mutual gains in SADC.

Improved collection information
The results of the survey confirm what had been noted earlier from the publicly available tax collection data, namely, that there is weak data in a number of countries concerning indirect taxes collected by customs. Also, there is weak data in many countries on the collection of arrears, the payments of refunds, the absorption of credit carry forwards, the types of arrears and collections arising out of different enforcement actions.

This situation persists despite computer-based maintenance of tax collection statistics in nearly all countries. The production of such data requires the upfront coding of data such that the key characteristics can be captured in management information and collection statistics using in monitoring and forecasting revenues. Similarly, weak reporting of the details of the costs of tax administration and any unit costs of tax administration is evidenced.

A co-operative project could be undertaken that would develop best practice advice for SADC Member States on tax collection data coding and reporting as well as for reporting unit costs and other performance measures of tax administration from the administration budget systems.

Strengthening computerization and introducing e-governance

As noted, most countries can still make improvements in the capacities of their computer systems for internal systems administration. More importantly, the emergence of internet-based services on the World Wide Web is now making powerful tools available to tax administration to communicate detailed and simple information to the taxpaying population as well as allowing the taxpayer to file tax returns, calculate taxes and make payments cost-effectively while also providing tax administrations with timely and accurate tax data.

A co-operative project could be undertaken to review existing e-governance techniques being used in the region and to advise SADC Member States on the development and use of e-governance techniques, at a minimum in the area of e-publishing and effectively communicating with the tax paying population. An addendum to this project could be the provision of technical assistance on

(a) the legal environment necessary to use the internet for e-filing and e-payments of taxes, and possibly
(b) technical issues and options arising in the introduction of e-filing and e-payments.

Preparations for functional administration: technical assistance and capacity building

International experience is showing that functional organization of tax administration offers opportunities to gain more effective use of scarce administrative resources, significantly more effective auditing and debt enforcement, and opens the door to providing more focused taxpayer services, such as the Large Taxpayer Unit. Preparatory to undertaking effective functional organization is the introduction of supportive tax legislation and training of personnel**.**

It is recommended that SADC Member States either review and co-ordinate administrative provisions across existing tax type legislation, or introduce a comprehensive tax administration law for all domestic tax types.

The review of the human resources in the tax administration of SADC Member States showed weakness in key areas where functional organization can be most effective, such as policy, assessment and audit. Many countries showed low shares of personnel with university and other post secondary training specific to tax administration. All countries had very small numbers of qualified accountants.

With the growing shift of tax administrations towards functional administration, this study has revealed the importance of examining tax administration capacities on a comprehensive basis to assess weakness and where co-operative support program may prove to be effective**.**

It is recommended that a SADC project be undertaken that goes further than the current study by undertaking a *combined* assessment of strategies that countries could undertake to migrate to functional organizations, and assessment of the training needs and delivery capacities of member countries, especially where human resource constraints are limiting computerization, introduction of e-governance, and functional organization.

The training considerations should go beyond accounting, auditing, tax legislation and tax system implementation, and should also look at weakness in management, project implementation, tax policy analysis, revenue forecasting and communications capacities.

SADC should undertake a study to develop a comprehensive regional training strategy that should advise on

(i) where regional training for routine tax administration activities (whether at an introductory or more advanced level) makes sense taking into account gains in economies of scale, but limited by country differences such as language, and

(ii) where regional and external or international training should be used to develop trainers, innovators and leaders in the tax systems at both middle and high levels. These types of training are enhanced by deeper, broader and more comparative approaches to education such that both the range of approaches and practices are studied along with the critical analysis of why they do or do not work in different country contexts.

The study should assess existing regional training capacities or centers, address the costs of training and professional education, and identify mechanisms for financing regional training centers. The study could also address the roles of the professional organizations, especially for the accounting profession, in training of personnel and the development approaches to improve the local tax systems within member countries.

Table 9.1 VALUE ADDED AND SALES TAX ADMINISTRATION IN THE SOUTHERN AFRICAN DEVELOPMENT COMMUNITY

	Angola	Botswana	Dem. Rep. of Congo	Lesotho	Malawi	Mauritius	Mozambique
Tax	Turnover tax on consumption.	VAT	Turnover tax (*Impôt sur le chiffre d' affaires*, or ICA)	VAT	VAT (Surtax)	VAT	VAT (IVA)
I. TAX ADMINISTRATION							
1.1.1 Organization Structure	Tax and customs administrations are separate depart-ments under the Ministry of Finance. Tax administration covers income and excise taxes, and customs collect consumption taxes on imported goods. Revenues from oils and diamonds are administered separately.	VAT is administered by the Department of Customs and Excise under the Ministry of Finance. Income tax is administered by a separate Department.	The General Tax Directorate (GDI) is set up under the Ministry of Finance, but it enjoys administrative and financial autonomy. GDI collects revenue on behalf of the Public Treasury under the Authority of the Ministry of Finance.	VAT is administered by a Division within Lesotho Revenue Authority (LRA), which is also responsible for collection of income taxes, customs, and excise duties. Tax policies are the responsibility of the Tax Policy Unit under the Ministry of Finance. LRA has established an economic unit to support the Ministry.	Established in 2000, Malawi Revenue Authority (MRA) is responsible for administering income taxes, import duty, excise duty, and VAT (surtax). MRA has three Divisions: Income Tax, Customs and Excise, and Surtax each operating independently under a Commissioner who report to the Commissioner General.	Department of the Ministry of Finance.	Domestic VAT−as well as excise duties and income taxes−is administered by the National Directorate of Taxes and Audit (DNIA), which is a department under the Ministry of Finance. Import VAT is collected by the National Directorate of Customs (DGA).
Revenue Authority	Revenue authority is under consideration, but not top priority.	Revenue Authority was to be established in 2004.	Part of Ministry of Finance with high degree of administrative and financial autonomy	The Lesotho Revenue Authority was formed on January 2003 under the auspices of the LRA Act.	MRA is an autonomous revenue authority.	The formation of a revenue authority is under serious consideration.	The Government is preparing for the establishment of a central revenue authority that will combine the function of DNIA and DGA.
Degree of Autonomy from Ministry of Finance and Public Service	Revenue administrations fall under the responsibility of the Ministry of Finance.	VAT is administered within the Department of Customs and Excise under the Ministry of Finance.	Part of Ministry of Finance with high degree of administrative and financial autonomy	LRA Board of Directors−which includes representative from businesses, legal, and accountancy profession−is appointed by the Minister of Finance.	MRA has a high degree of autonomy. It operates on a commercial basis with an independent Board of Directors.	VAT administration runs autonomously under a Commissioner.	DNIA and DGA are departments under the Ministry of Finance.
Degree of Functional Administration	The revenue administrations are organized across functional areas, including collection, legal, audit, advice, special investigation/research, and administration/human resources.	Separate tax type department with Customs and Excise department	One organization for inland revenue, and appears to be functionally organized. Customs under separate administration	LRA is organized around tax types. Each division has its own debt management and investigative arms, although merging these functions for all types of taxes is under consideration.	There are cross functional support departments under the MRA headquarters that provide administrative services: - Board Secretary - Legal Council - Finance and Administration - Tax Audit and Investigation - Information Technology - Policy Planning/Research - Internal Audit - Public Relation	The tax administration is organized by tax type, except for the Large Taxpayer Department where each tax function covers all type of taxes.	IVA, excise, and income taxes are organized as a separate division with significant degree of functional integration: large taxpayer unit, audit, and debt management.

Table 9.1 VALUE ADDED AND SALES TAX ADMINISTRATION IN THE SOUTHERN AFRICAN DEVELOPMENT COMMUNITY *(contd)*

	Namibia	South Africa	Swaziland	Tanzania	Zambia	Zimbabwe
Tax	VAT	VAT	Sales Tax	VAT (introduced in July 1998)	VAT	VAT (introduced in January 2004)
I. TAX ADMINISTRATION						
1.1.1 Organization Structure	Tax administration is the responsibility of the Ministry of Finance. The Commissio-ner of Inland Revenue oversees 2 directorates: (1) The Directorate of Inland Revenue is responsible for income tax, VAT, transfer and stamp duties, and petroleum taxation. (2) The Directorate of Customs and Excise	The South African Revenue Service (SARS) is an autonomous organization. It is not part of the Ministry of Finance.	Sales tax is administered by the Department of Customs and Excise, and employees are part of the Civil Service. Income tax is administered by a separate government department.	VAT administration on the mainland is the responsibility of Tanzania Revenue Authority (TRA). The TRA has a board of ten Directors and the senior official is the Commissioner General. Five members are ex-officio, other Members of the Board are from the private sector and represent appropriate professions. The Board has a mandate to advise the Minister of Finance on tax policy.	VAT is administered by a distinct division under the Commissioner of VAT within the Zambia Revenue Authority (ZRA). A Governing Board oversees the operations of ZRA. The ZRA is responsible for VAT, customs and excise duties, income taxes, property transfer tax, and mineral royalty.	Zimbabwe Revenue Authority (ZIMRA).
Revenue Authority	Namibia does not have a revenue authority.	SARS is a revenue authority.	Currently there is no revenue authority. However, the government is considering to introduce of an independent revenue authority in 2006. The authority would be responsible to administer customs, excise, and VAT.	Tanzania Revenue Authority was formed in July 1996.	Zambia Revenue Authority was formed in April 1994.	Zimbabwe Revenue Authority was established in January 2001.
Degree of Autonomy from Ministry of Finance and Public Service	The Directorate of Inland Revenue is under the Ministry of Finance.	SARS has considerable degree of autonomy. SARS Act is independent from the Civil Service.				ZIMRA is an autonomous organization.
Degree of Functional Administration	Within the Directorate of Inland Revenue, each type of taxes is administered separately. However, functionalities such as audit, debt collection, large trader, and special investigations are covering all taxes.	The tax administration is organized across functional areas. There are 8 General Managers that form the Executive Committee of SARS. Each General Manager has a specific responsibility: Taxpayer Service, Customs, Assessment, Enforcement, Strategy & Planning, Law Administration, and Finance & Human Resources. General Managers report to the Commissioner. The operations, enforcement, and administration of VAT is incorporated within the above structure.	The collection of sales tax is integrated under the Commissioner of Customs.	There are 4 departments within TRA: VAT, Income Tax, Customs and Excise, and Large Taxpayers. The taxes are administered separately, but a new corporate plan is already in place to combine tax functions, such as audit, taxpayer service, and returns processing. Presently, there are 8 crosscutting support departments: finance, tax investigations, information systems, human resources, research and policy, internal audit, legal affairs, and taxpayer education.	There are three operational divisions: Customs and Excise, Income Tax, and VAT. Supporting directorates covers all types of taxes: Administration, Human Resources, Legal and Information Technology, Internal Audit, Internal Affairs, and Executive Support Unit.	ZIMRA is organized around functional divisions which cover all types of taxes: Investigation, Planning, Internal Audit, Operations, Human Resources, Finance and Administration, Legal Advice and Corporate Secretarial.

		Angola	Botswana	Dem. Rep. of Congo	Lesotho	Malawi	Mauritius	Mozambique
	Appointment of Managers	Appointed on normal promo-tion from within the Ministry of Finance.	Appointment is made pursuant to the Public Service Act. Top managers report to the Permanent Secretary, Ministry of Finance through the Secretary for Financial Affairs.	General Director and his/her Deputy are appointed by the President. Directors are appointed and dismissed by the Minister of Finance.	Minister of Finance appoints Commissioner general Board of Directors appoints directors and senior managers.	The Commissioner General is contracted for 5 years and is appointed by the Minister of Finance with Presidential approval. The MRA Board appoints other Commissi-oners and Deputy Commissioners.	The VAT Commissioner is appointed by the Public Service Commission, and reports to Financial Secretary.	Managers appointment follows regular civil service recruitment rules.
1.1.4	**Large Taxpayer Unit (LTU)**	There is a unit set up to service the biggest taxpayers across all taxes.	No large taxpayer unit.	Directorate for Large Companies (Direction des Grandes Enterprises, or DGE)	There a large taxpayer unit in each division for each tax type.	Large Taxpayer Unit was established in November 2004. Covers auditing, but not collections.	Large Taxpayer Department is a separate unit that administers all tax functions of income taxes and VAT.	There is a large taxpayer unit in three DNIA offices: Maputo, Beira, and Nampula. These large taxpayer units cover all types of taxes under the jurisdiction of DNIA.
	Criteria to be Serviced by LTU	Minimum turnover level and type of industry (oil, diamond, and public sector).	N/A	Turnover above $300,000 Taxpayers with turnover less than $300,000, but above $72.000 are served by the Tax Centers (CDI). Taxpayers with turnover less than $72.000 are served by the Synthetic Tax Centers (CIS).	Turnover above M 500,000.	Turnover used as criterion	Turnover above Rs 200 million.	Companies with turnover above 1 billion meticash per month, or with large number of labor force paying PAYE.
	Number of Taxpayers Served by LTU	350 Companies.	N/A	400 companies	20% of registered taxpayers are serviced by the LTU.	50 taxpayers	249 VAT taxpayers.	322 in Maputo; 149 in Beira; no data in Nampula.
	Share of Revenues of the LTU	Revenue collections of the biggest taxpayer unit constitute 60% of the total national revenues.	N/A	75% of revenues.	80% of total VAT revenues.	N/A	20% of VAT revenues.	No data available.
1.2.1	**Tax Administration Expenditures**	No data available.	For FY 2002/2003, the total expenditures were P 44.6 million. Personnel constitute 72% of the total expenditures.	The Treasury hands back 7% of DGI revenue collections as operational expenses.	FY 2003/4: M 60.4 million.	No data available.		No data available.
	Administrative Expenditures on Customs	No data available.	For FY 2002/2003, the total expenditures for customs administration were P 33.5 million.	No data available.	FY 2003/4: M 24.2 million.	No data available.	FY 2003: Personnel Rs. 111.3 million Oth. Current Rs. 62.9 million Capex Rs. 2.3 million	No data available.
	Administrative Expenditures on VAT/Sales Tax	No data available.	VAT consumes 25% of the Customs budget. For FY 2002/2003, the total expenditures for VAT administration were P 8.1 million.	No data available.	FY 2003/4: M 12.9 million.	No data available.	FY 2003: Personnel Rs. 28.2 million Oth. Current Rs. 11.2 million Capex Rs. 2.8 million	No data available.
	Budget Allocation	Part of the normal budgeting process within the Ministry of Finance.	Negotiated each year with the Ministry of Finance	DGI receives 7% of the revenue collections for its operational costs.	Under the current LRA Act, the LRA is funded by 2% of estimated revenues. This formula is to be reviewed.	The MRA is funded by Government Grant as a normal budget vote.	Budget is negotiated each year with the Ministry of Finance.	Budget is allocated by the Ministry of Finance.

Table 9.1 VALUE ADDED AND SALES TAX ADMINISTRATION IN THE SOUTHERN AFRICAN DEVELOPMENT COMMUNITY *(contd)*

	Namibia	South Africa	Swaziland	Tanzania	Zambia	Zimbabwe
Appointment of Managers	Vacancies are advertised in internal circulars.	Appointments are through the normal recruitment process. There is not a specific VAT Commissioner. The Commissioner of SARS acts as the commissioner for all taxes.	Appointments of Deputy Commissioners and above are made by a Civil Service Board. The Minister of Finance approves all senior managers' appointments.	The Chair of the Board is appointed by the President. The Minister of Finance appoints the Commissioner General, and approved by the President. Positions at Deputy Commissioner and above are filled by open competition including interviews by the TRA Board.	Post of Assistant Commissioner and above are subject to a competitive internal and external process. The Board of ZRA holds selection interviews. These posts are filled on a 5-year contract basis.	Posts are advertised and the Board interviews short listed candidates. Top managers report to the Commissioner General who is an ex officio member of the Board. Senior managers are employed on a 3-5 year contract basis.
1.1.4 Large Taxpayer Unit (LTU)	Monitoring of large taxpayers is primarily a function of the Income Tax Directorate.	There is currently no large taxpayer unit, but it is under consideration.	There is no large taxpayer unit.	Large Taxpayer Unit is a separate department under a Commissioner. The LTU is multifunctional and includes income taxes, customs, and VAT.	There is no large taxpayer unit in place, but there is a large trader control team for VAT that carries out audits on large traders.	No large taxpayer unit, although payments of large taxpayers are closely monitored.
Criteria to be Serviced by LTU	Turnover and complexity (i.e., mining companies, financial institutions, and commercial fishing).	N/A	N/A		N/A	N/A
Number of Taxpayers Served by LTU	15 large taxpayers are VAT registered.	N/A	N/A	About 5% (or 114) of registered VAT payers are served by the LTU.	N/A	N/A
Share of Revenues of the LTU	No data available.	N/A	N/A	About 24% of VAT revenues are collected by the LTU.	N/A	N/A
1.2.1 Tax Administration Expenditures	FY 2003: Salaries: N$ 25.1 million Others: N$ 9.9 million. FY 2002: Salaries: N$ 18.1 million Others: N$ 13.0 million.	FY 2003: Personnel: R 1.7 billion Others: R 1.2 billion. FY 2002: Personnel: R 1.5 billion Others: R 0.8 billion.	FY 2003: Personnel: E 12.7 million Capital: E 779,000. FY 2002: Personnel: E 11.2 billion Capital: E 200,000.			No data available.
Administrative Expenditures on Customs	No data available.	The accounting system does not allow to disaggregate expenditure by tax type.	No data available.			Operations are integrated. The accounting system does not allow breakdown by tax type.
Administrative Expenditures on VAT/Sales Tax	The accounting system does not allow to disaggregate expenditure by tax type.	The accounting system does not allow to disaggregate expenditure by tax type.	No data available.			Operations are integrated. The accounting system does not allow breakdown by tax type.
Budget Allocation	Government department funding is negotiated as part of the normal budgeting process.	Negotiated each year with the Ministry of Finance.	The department is funded by the budget vote following negotiation with the Ministry of Finance.	The TRA Act stipulates that TRA to be funded from a proportion of revenue receipts, plus grants or loans and own resources. However, the practice has been that the TRA funding is negotiated with the Ministry of Finance annually.	The Authority is a corporate autonomous body funded through the National Budget. The budget is negotiated each year with the Ministry of Finance.	Negotiated each year with the Ministry of Finance as a normal budget item.

Table 9.1 VALUE ADDED AND SALES TAX ADMINISTRATION IN THE SOUTHERN AFRICAN DEVELOPMENT COMMUNITY *(contd)*

	Angola	Botswana	Dem. Rep. of Congo	Lesotho	Malawi	Mauritius	Mozambique
1.3.1 **Number of Registered Value-Added Taxpayers**	Total number of registered taxpayers is 1.15 million (individual) and 150,000 (business). No specific data on the number of turnover taxpayers.	10,471 (May 2004).	No data available except for the 400 taxpayers served by the Directorate of Large Taxpayers.	1,350 taxpayers.	2,826 taxpayers (March 2004).	7,077 taxpayers (June 2003).	332,149 taxpayers (Dec 2003).
Number of Active Value-Added Taxpayers	No data available.	10,365 (May 2004).	No data available.	1,200 taxpayers.	1,801 taxpayers.	Approx. 6,965 taxpayers.	No data available.
Taxpayer Size Frequency Distribution	No data available.	Top 16 (0.2%) largest companies by annual turnover responsible for 18% of the total VAT revenues. Top 53 (0.7%) largest companies by annual turnover responsible for 32% of the total VAT revenues.	No data available.	14.0% with turnover greater than M 5 million. 61.2% with turnover greater than M 500,000 but less than M 5 million. 24.8% with turnover less than M 500,000 (registered voluntarily).	24.8% with turnover greater than MK 10 million. 23.1% with turnover greater than MK 2 million but less than M 10 million. 52.1% with turnover less than MK 2 million (registered voluntarily).	Top 2.3% taxpayers with turnover of more than Rs. 100 million contribute 20.4% of the total tax as per return. The bottom 62% taxpayers with turnover of less than Rs. 5 million contribute 10% of the total tax as per return.	No data available.
Minimum Business Turnover for Compulsory Registration	No lower limit − anyone supplying goods or services liable to consumption tax should register and remit the tax.	P 250,000	No data available.	M 500,000	MK 2,000,000.	Rs. 3,000,000. No minimum for 28 specified businesses.	Three Tier Registration: Normal - Turnover > 250 mil. Simplified - Turnover > 100 mil Exempt (require to register)
1.4.1 **Number of Consumption Tax Officer Positions (Filled and Vacant)**	No data available. Income and consumption taxes are carried out on a combined basis. The National Directorate of Tax Administration has 60 staff in the head office and about 171 in the regions. (5,600 taxpayers per official; 649 corporate taxpayers per official)	151 positions filled. No vacant position. (69 taxpayers per official)	No data available.	Total staff: 88 (15 taxpayers per official) Vacancies: 8	Total staff: 127 (22 taxpayers pe	Total Positions: 176 (40 taxpayers per official) Vacancies: 28	No data available.
Number of Officers with University Degree	Seven (3%); an effort to raise the number, preferences is being given to degree holders at recruitment.	49 out of 151 officers (32%) have a university degree.	Approximately 2.5% of the total personnel have a university degree.	90% of the personnel have a university degree. LRA requires a university degree and more than 2 years experience for senior positions.	20 (2 with Master's degree)(16%	6 personnel (3%)	No data available.
Number of Qualified Professional Accountants	Ten.(4%)	None.	No data available.	8 qualified professional accountants (9%).	4 in the Audit and Investigation Team, which is also responsible for VAT (surtax) (3%)	11 persons (6%)	No data available.
Number of Officers with Post Secondary School Certifications	No data available.	No data available.	Approximately 17.5% of the total personnel have post secondary school certifications.	To join LRA, the minimum requirement is a diploma.	11 (9%)	102 persons.(58%)	No data available.
Number of Support Staff in Establishment	No data available.	15 positions filled. No vacancy.(30%)	Approximately 2.5% of the total personnel are in the support staff category.	1 secretary and 3 drivers. The drivers are not included in the above 88 total staff.(5%)	14 (11%)	58 positions (33%) 8 vacant	No data available.

Table 9.1 VALUE ADDED AND SALES TAX ADMINISTRATION IN THE SOUTHERN AFRICAN DEVELOPMENT COMMUNITY *(contd)*

	Namibia	South Africa	Swaziland	Tanzania	Zambia	Zimbabwe
1.3.1 **Number of Registered Value-Added Taxpayers**	14,000 (January 2004).	1,035,495 businesses are on the register as at December 2003.	1,138 sales taxpayers (Jan 2004).	13,464 (June 2003).	23,333 (January 2004). 2004 budget changes that raised the turnover limit and disallowed voluntary registration would remove 70% of the register.	6,000 so far. More applications are being processed daily.
Number of Active Value-Added Taxpayers	Approx. 2,300 are non filers.	506,098 taxpayers (Mar 2003).	834 sales taxpayers (Jan 2004).	11,114 (June 2003).	Approx. 8,000 (January 2004).	
Taxpayer Size Frequency Distribution	No data available.	No data available.	No data available. The main groups in the register are importers, exporters, and service providers (architects, lawyers, etc.).	About 8.3% of taxpayers have a turnover of more than T.shs. 500 million The bottom 50% of taxpayers have a turnover of less than T.shs. 20 million.	> ZMK 100 million 31% ZMK 50−100 million 20% < ZMK 50 million 49%	
Minimum Business Turnover for Compulsory Registration	$ 200,000, but voluntary registration is allowed.	R 300,000.	E 20,000.	T.shs. 20 million. About 50% (6,254) of registered traders have turnover below this level.	ZMK 200 million (effective Feb 2004), and no voluntary registration allowed.	Zim $ 250 million. (approx. US $ 20,000)
1.4.1 **Number of Consumption Tax Officer Positions (Filled and Vacant)**	Total in Establishment: 41 Number Filled: 36 Number Vacant: 5 Officers are responsible for both VAT and income taxes. VAT requires approximately one-third of the time. (341 taxpayers per official)	It is difficult to identify dedicated VAT personnel. The total number of SARS personnel is 12,265 (March 2003). (84 taxpayers per official)	Total positions available in the Customs, Excise, and Sales Tax Department is 201. (6 taxpayers per official) Filled: 182 Vacant: 19	507 personnel. (27 taxpayers per official)	Approved Establishment: 218 (107 taxpayers per official) Current: 183 Vacancies: 35	
Number of Officers with University Degree	5 personnel (12%)	3,770 (26.7%) of the personnel have tertiary qualifications (university degree and diplomas).	26 personnel (13%)	269 personnel (53%).	102 personnel (47%).	Approximately 80% staff.
Number of Qualified Professional Accountants	None.	128 chartered accountants are employed at SARS. This number is included in the above total (1% of total staff or 3% of staff with tertiary qualifications)			6 personnel (not included in the figure above).(3%)	
Number of Officers with Post Secondary School Certifications	6 personnel.(14%)	777 officers are identified with other post secondary school certificates, which include taxation, forensic audit, information technology, VAT, etc.(6%)	54 persons have post secondary school qualifications (25%)	238 personnel (47%).		About 20% of staff.
Number of Support Staff in Establishment	Total in Establishment: 25 Number Filled: 23 Number Vacant: 2 Shared between VAT and direct taxes.	Approximately 5,000 support and administrative staff. It is not possible to distinguish between administrative and other functions.(40%)	135 positions filled (67%) 15 vacant.	498 personnel across all departments.	Approved Establishment: 27 (12%) Current: 25 Variance: 2	

Table 9.1 VALUE ADDED AND SALES TAX ADMINISTRATION IN THE SOUTHERN AFRICAN DEVELOPMENT COMMUNITY *(contd)*

	Angola	Botswana	Dem. Rep. of Congo	Lesotho	Malawi	Mauritius	Mozambique
1.5.1 **Pay Scale Relative to Civil Service**	Same as civil service.	Same as civil service.	Same as civil service, plus bonuses derived from the specific duties, revenue realized, and tax disputes.	LRA salaries are approximately double that of civil service.	For pension able, MRA salaries are approximately double that of civil service. For contract employees, the salaries are more than double that of civil service. Benefits for senior management include performance bonuses and car & housing allowances, which are not provided for civil service.	Same as civil service.	Same as civil service.
Condition of Employment Relative to Civil Services	Same as civil service.	Same as civil service.	Generally similar to the civil service.	Benefit packages tend to be more salary focused, with less allowance (car/housing) than that of civil service.		Same as civil service.	Same as civil service.
Comment on the Adequacy of Salary and Benefit Packages to Retain Tax Officers	Recruitment is not generally difficult given the high rate of unemployment. However, it is difficult to recruit quality established professionals from the private sector.	Government pay scales are not adequate to retain qualified tax officers and to discourage moves to the private sector.	Current salaries are perceived inadequate to retain qualified personnel and to prevent corruption.	Benefit packages are far better than that of the civil service, but not fully aligned to private sector.	Staff retention is not a serious problem, but recruitment for certain positions (e.g., lawyers) is more difficult to attract quality professionals from the private sector.	Not adequate. Recruitment of quality staff and professionals from the private sector is difficult.	Not adequate. Recruitment and retaining of quality and professional staff.
1.6.1 **Degree of Computerization of Customs Administration**	Not known.	Customs administration processes, including customs clearing and enforcement, and databases are computerized.	Data from tax forms and accounts are computerized, but parallel paper process is maintained as final basis for customs clearing and enforcement.	Only revenue collection and trade statistics are computerized.	Computerization of customs is still limited, even though Asycuda system is in place and being enhanced.	The Customs and Excise Department is connected to the sophisticated TradeNet system.	No information available.
Degree of Computerization of VAT/Sales Tax Administration	Only revenue collection statistics are computerized.	Data from tax forms and accounts are computerized, but parallel paper process is maintained as final basis for administration and enforcement.	Data from tax forms and accounts are computerized, but parallel paper process is maintained as final basis for administration and enforcement.	All data from VAT forms and accounts are computerized, but parallel paper process is maintained as final basis for administration. The VAT system (VIPS) includes general ledger, risk assessment, automated penalty, and on-demand reporting modules.	The surtax system uses the same register (taxpayer id generator) as the income tax and Asycuda systems. Tax returns are entered into the computer, but it has limitations in the number of data recorded. Most reports are for collection statistics.	The VAT administration has a sophisticated computer system based on Unix (Solaris) operating systems. The server is connected to 97 PCs with linkages to Customs, Large Taxpayer Income Tax, Accountant General, and Mauritius Network Services.	All data from VAT forms and accounts are computerized, but parallel paper process is maintained as final basis for administration. The VAT system (VIPS) includes general ledger, risk assessment, and on-demand reporting modules. However, the full potential of the system is not being utilized.

Table 9.1 VALUE ADDED AND SALES TAX ADMINISTRATION IN THE SOUTHERN AFRICAN DEVELOPMENT COMMUNITY *(contd)*

	Namibia	South Africa	Swaziland	Tanzania	Zambia	Zimbabwe
1.5.1 **Pay Scale Relative to Civil Service**	Same as civil service. Officers are civil servants.	SARS has a higher remuneration packages than that of the civil service with comparable rank.	Same as civil service.	Pay scale are generally higher than that of the civil service.	Remuneration is approximately double than that of civil service.	The pay scale is different from that of the civil service.
Condition of Employment Relative to Civil Services	Same as civil service. Officers are civil servants.	Conditions of employment are different to the civil service. Salary levels, leave benefits, staff grades are different from that of the civil service. Affirmative action is a strong factor in the employment policies and processes.	Same as civil service.	For Deputy Commissioner level and above, the employ-ment is on a 3-year contract basis. They receive bonuses based on performance. Some senior grades also receive car, housing, and medical benefits. These do not apply to civil service.	The salary and other allowance scales are higher than in the civil service. The ZRA recruits its own members of staff without government intervention.	Some officers receive car, housing, and educational allowances.
Comment on the Adequacy of Salary and Benefit Packages to Retain Tax Officers	The civil service salary is not regarded as sufficient to retain tax officers, particularly those with tertiary qualifications.	The SARS remuneration policy is higher than that of the market at the lower grades, match the market at the middle grades, and lower than the market at the senior grades. SARS is in a position to make a limited counter offer in cases where SARS wishes to retain the service of a particular employee.	Salaries are deemed adequate to both recruit and retain staff across the board.	Recruitment is rather difficult to hire the best people because salary and benefits packages are less than that of the private sector.	ZRA employs a lot of qualified personnel and tries to be as competitive as possible. Experience shows that qualified accountants in the lower managerial grades are often tempted to more lucrative private sector packages.	The package is seen as "average" in the market. Some officers were leaving for better packages in the private sector.
1.6.1 **Degree of Computerization of Customs Administration**	Customs data are compu-terized, but parallel paper process is maintained. An Asycuda ++ is being rolled out throughout the country.	Data from tax forms and accounts are computerized, but parallel paper process is maintained as final basis for customs clearing and enforcement. A greater degree of computerization is being pursued on an on-going basis.	Only trade statistics are computerized. Separate paper records are maintained as the basis for customs clearance.	An Asycuda system is installed to support the customs administration.	Data from tax forms and accounts are computerized. Computer generated Single Administrative Document (SAD) in printed form is issued to the declarant signature as proof of being the source of the declaration.	Data from tax forms and accounts are computerized, but parallel paper process is maintained as final basis for customs clearing and enforcement.
Degree of Computerization of VAT/Sales Tax Administration	Customs data are compu-terized, but parallel paper process is maintained. The currently installed system was developed in house. A plan to introduce a "Bull" computer system is well advanced.	VAT is fully computerized. However, paper files are still maintained to keep track of correspondence and returns submitted.	Only registration and returns data entry are computerized. Other functions, including balance calculation, are done manually.	A VAT Information Processing Systems is being used. The revenue statistics generated by this system is delayed by about two weeks due to the requirement for manual intervention.	All VAT administration processes are computerized and databases are computerized which is also the primary basis for administration and enforcement. The VAT information processing system is being upgraded to a more advanced system, which will link direct and indirect taxes.	VAT is computerized (SAB System), but manual records are still maintained to keep track of correspondence and returns submitted.

Table 9.1 VALUE ADDED AND SALES TAX ADMINISTRATION IN THE SOUTHERN AFRICAN DEVELOPMENT COMMUNITY *(contd)*

	Angola	Botswana	Dem. Rep. of Congo	Lesotho	Malawi	Mauritius	Mozambique
1.7.1 Internal Audit and Organization of Audit Capacity	No info on internal audit capacity. Taxpayer audits cover all type of taxes, including direct taxes, consumption taxes, and customs. Audits are normally carried out at the business premises.	Internal Audit is based at the Customs and Excise Headquarters. VAT auditors are based at regional offices. The auditors report to the regional managers.	No info on internal audit capacity. There are 260 auditors distributed across tax offices. Forty of the auditors are based at the Directorate of Large Taxpayer.	VAT audits are primarily carried out at the business premises.		There is a special internal audit team of two people that reports directly to the Commissioner. This team checks only internal system, not dealing with businesses.	No internal audit procedures are being employed.
Desk Audit Procedures	No specific desk audit procedure other than pre visit preparation.	Desk audits are normally applied to low risk companies. When requested, traders have to bring supporting documents to the officers for verification of tax declarations.		Desk audit are conducted for all refund claims. The desk audit will either allow or disallow refunds, or select the claim for field visit.	Desk audit includes preparation for field visit and verification for refunds.	**Routine Desk Audit**: - Each month, files are allocated by the supervisor according to the predeter-mined selection criteria. - Audit officers extract information also from other sources, and prepare report with recommendations. - Supervisor submits his/her own comments and report to the Assistant Commissioner for further action. - Supervisor updates the computer record accordingly. Note: 6 officers in routine desk audit 9 officers in repayment desk audit.	Desk audit are conducted for all refund claims. The desk audit will either allow or disallow refunds, or select the claim for field visit.
Organization of Field Audit Capacity	There is an audit unit at the head office, at the biggest taxpayer unit, and in each regional office.	Potential risks, amount of tax involved, and resources available.	Most audits are conducted at the taxpayer premises. A field audit can be executed by a duly mandated tax officer. No further audit shall be conducted in respect to a tax or period that has already been audited.	VAT auditors are divided into three teams: (1) large taxpayer unit; (2) routine and refund verifications; and (3) other taxpayers unit. Each team is headed by a principal officer who supervises 5 senior inspectors and 5 inspectors. Field audits are carried out in teams of two officers.	Nationally, there are 30 officers responsible for audits: 2 Principal Officers who supervise senior revenue officers, revenue officers, assistant revenue officers, and revenue assistants. Two Assistant Commissioners and an Assistant Regional Manager oversee the audit practice. Field audits are conducted in pair.	There are 7 field audit units, each headed by a supervisor. The audit supervisors report to Assistant Commissioners. In addition, 5 investigating officers, who work directly under an Assistant Commissioner, conduct in-dept audits which may lead to additional assessments.	Audit falls under the Deputy Director of Audit. The audit function has two parts: - A team for routine audits, which cover VAT, excise, and income taxes; - A second, smaller team that looks at suspect of VAT businesses.
Number and Qualifications of Field Auditors	40 auditors at the head office and 10 auditors at the biggest taxpayer unit. No data for regional offices.	University Degree: 35 Diploma: 23 Certificate: 6 Total: 64	No data provided.	34 VAT auditors.		Number of officers in the Audit Section is 68. Qualifications include London Chamber of Commerce Accounting, Pitman Advanced Bookkeeping, Diploma in Business Administration, B.Sc. Economics.	No data available.

Table 9.1 VALUE ADDED AND SALES TAX ADMINISTRATION IN THE SOUTHERN AFRICAN DEVELOPMENT COMMUNITY *(contd)*

	Namibia	South Africa	Swaziland	Tanzania	Zambia	Zimbabwe
1.7.1 **Internal Audit and Organization of Audit Capacity**	The Ministry of Finance has an internal audit unit with staff reporting directly to the Permanent Secretary.		Auditing for both Customs and Sales Tax is carried out under the Inspectorate Sub-Division. The unit reports to the officer in charge of the Inspectorate Division.	TRA has a dedicated internal audit department. Atypical field office includes an operations and a compliance sections. The operations section will carry out the initial sift of desk audit for refund claims. The compliance section conduct field visit and enforcement.	The ZRA has a specific internal audit team to look at ZRA systems across the board. This team reports directly to the Commissioner General.	An internal audit division report directly to the Commissioner General through the Internal Audit Manager.
Desk Audit Procedures		The risk analyzers allocate the audits to the auditors who then required to analyze and audit the case. Audit report is submitted to the audit manager once the auditor is satisfied with the findings. If differences are found, assessment are raised electronically for approval by the audit manager.	There is no desk audit as such for sales tax. Officers, however, do plan and carry out desk-based intelligence and information gathering.	**Repayment Claims**: The operations section examines tax returns and VAT clearance certificate for exporters. The certificate is a requirement that must be certified by an independent auditor. All repayment claims are then passed to headquarters for final examination. **Pre-Visit Preparation**: This includes previous visit report, the trader's ledger, and return analysis sheet produced by the VIPS.	Parameters are set onto the VAT system. Some returns that fail the set parameters are sent for short audits, while the rest are subjected to internal desk audit. A check list is used to help the desk inspection function.	Desk scrutiny of repayment claims is in place.
Organization of Field Audit Capacity	Field auditors for VAT are usually Senior Taxation Officer-level. They always visit in pairs. Most visits take one day. Auditors set the time alloted for visit, and it is presented in weekly plan.		The audit unit is divided into smaller units of three officers and a team leader. After each assignment, the various team leaders report to the officer in charge of the audit team about their findings in their audit work.	Regional Audit Manager supervises both operations and compliance sections. Deputy Manager oversees the compliance section. Senior Officer directly manages and oversee a team of auditors. Two officers form an audit team and visit jointly. There are 24 auditors based in Dar es Salaam offices covering 7,000 traders.	8 investigations (criminal) officers, 18 large trader inspectors, and 102 short and long audit inspectors (excluding desk audit).	
Number and Qualifications of Field Auditors	Qualifications: Senior Tax Officer.	There are 1,469 auditors responsible for all taxes.	Generally, there is no minimum qualification requirements to be employed as an auditor. However, 12 of the officers do have a degree in accounting, management, and law. No information about the total number of auditors.	254 field auditors. Most of them have a degree in taxation, accounting, economics, and finance.	128 officers with minimum qualification of a diploma for Assistant VAT Inspector, and a degree for VAT Inspector.	No data available.

Table 9.1 VALUE ADDED AND SALES TAX ADMINISTRATION IN THE SOUTHERN AFRICAN DEVELOPMENT COMMUNITY *(contd)*

	Angola	Botswana	Dem. Rep. of Congo	Lesotho	Malawi	Mauritius	Mozambique
Audit Selection Process	The targets to visit all businesses annually. Audit Selection is done manually by looking such indicators as late returns, cross references from other audits, and information received.	Manual Risk Assessment: assign points based on returns submitted, previous audits, tip offs, company records.	All 400 large taxpayers are audited annually. About 15% (1.500) of medium sized taxpayers are audited annually by the Tax Centers. About 5% of small-sized taxpayers are audited by the CIS.	At present, audit selections are still done manually. This process will be automated and included into VIPS in the future.	Principal Officers select audits manually based on their experience. The Surtax computer has the option to record complexity and compliance points, as a measure of risk. This facility, however, is not used.	- Exception lists extracted from the computer system - Un-audited cases over a specified period - High revenue risk cases - Random sampling - Cases referred by other parties	Audits are selected manually by managers.
Type and Frequency of Audits	The law makes provision for all businesses to be visited within a five-year period. The audit unit aims to carry out 15 audits a month, normally carried out in pairs. Small business audits usually last 2-3 days, and larger business 5-8 days.	Field audits constitute 80% of the total time allocated. No information about the frequency and coverage.	First-level audits based on records are conducted once a year. Second-level audits are conducted once. No further explanation on the first- and second-level audits.	Desk audits and verification visits are conducted as required. Intensive field audits are conducted once a year. Each visit by two officers may last for 2 days for small taxpayers to one week for large taxpayers.	Businesses are audited within 3 months of registration. No information about the audit frequency after that. All excess returns are audited.	Every business will be visited once every 5 years. Investigations are carried out when it is considered justified.	
Audit Reports and Follow Up Procedures		An audit report includes audit objective, background information, risk analysis, and trader's accounting systems. Additional assessment as a result of an audit process will be followed by the debt management.	Auditors' supervisor will validate the tax adjustment based on the multidisciplinary auditor reports following an audit process. The supervisor is responsible for the monitoring and follow-up.	Audit reports are compiled and approved by principal officers. Measure of compliance and new assessment are fed into the VIPS.	Auditors make visit reports, which are scrutinized by a Principal Officer. All reports are also scrutinized by Assistant Commissioner. If and additional tax assess-ment is raised, the report is forwarded to the Commissioner General for his comments, and possibly additional penalties.	Audit report covers description of the business, books and records kept, bank accounts, input-output check, and discrepancies observed. Follow up procedures: - Reports are reviewed by the supervisor followed by recom-mendations - The Assistant Commissio-ner−after consultation with senior management, if necessary−takes the final decision.	Audit reports are scrutinized by the Head of Office and the National Director, who can request a follow up audit by a different team.
Oversight Procedures for Field Audit	Head of Section and Head of Office review audit reports. Director has to be notified for large assessment. There is no procedure for additional management checks.		The supervisor is responsible for the monitoring and follow-up. No further detail on the oversight procedures for field audit.	Principals initiate, review, and approve audits, as well as follow up on progress.		No formal management program, although senior management may request for an already audited file to be reviewed by some other officers or the internal audit team.	Audit reports are scrutinized by the Head of Office and the National Director, who can request a follow up audit by a different team.
1.8.1 Organization of Debt Collection	The debt collection is part of the tax administration function and it covers all type of taxes.	Separate unit within the VAT Division.	Taxpayers self-assessed their tax and remit payments together with the tax returns. Additional official assessment must be paid within two weeks after the notice issuance. Tax Registrar will issue a notice to third parties (*Avis à tiers détenteurs*) to make a seizure of assets and put the seized assets up for auction.	Each type of tax has a separate debt management unit. Debts are established using VIPS data.	Each Tax Division has a separate debt management unit, but frequently surtax debts are pursued jointly with that of income tax. Given the limitation of the computer systems, debt collection is administered manually.	There is a section in the department under the responsibility of an Assistant Commissioner.	There is a debt collection unit (DCU) is the tax offices. This unit is responsible to recover debts from all type of taxes under the jurisdiction of DNIA.

Table 9.1 VALUE ADDED AND SALES TAX ADMINISTRATION IN THE SOUTHERN AFRICAN DEVELOPMENT COMMUNITY *(contd)*

	Namibia	South Africa	Swaziland	Tanzania	Zambia	Zimbabwe
Audit Selection Process	Audit selection is done manually; risk assessment is not used.	The risk analyzers identify cases for audit and allocate according to the type of audit required (desk or field) and further classified as routine, refund, or in-depth. Audit report and any assessment raised are submitted to the audit manager.	Risk is assessed manually by the audit officer based on the records from past audits and other information, and classify the taxpayer into high risk, low risk, risk neutral, and other (for importers who imports only duty free goods).	The VIPS select some cases for audit based on the risk measurement. Complexity and compliance points are allocated to taxpayers after audits. In practice, the manual selec-tion criteria is more often used because of the resource constraint.	All audits are selected manually at Assistant Commissioner level using a combination of manual, VAT system, and an internal information database to provide a judgment of the degree of taxpayer risks. After visits, officers provide a compliance and complexity rating for the trader to be entered into the system.	Not yet developed.
Type and Frequency of Audits	All taxpayers should be visited at least once in 5 years. Refund audits are selected randomly based on risk from cheques cycles printed every Monday.	Audits are classified as desk, routine, refund, and in-depth. Taxpayers are also referred to audit when applying for de-registration. The target is to visit every registered taxpayer at least once in a 3-4 year cycle, but the coverage in 2002/3 was only 10.2%. Risk profiling has become a greater factor.	High Risk: every 2 years Low Risk: every 5 years Risk Neutral: every 4 years Other: as necessary. Income tax and sales tax auditors sometimes combined audits and share information.	Large taxpayer − once every year for routine audit. Medium-sized taxpayers are suppose to be visited once every two years. Small taxpayers are visited once every three years. VIPS sets an "assignment value" that estimates the length of visit time.	-Visits at an interval 1-3 years that cover the period since the last audit visit. '-Visits to traders whose returns have failed set parameters−this often be pre-repayment visits. Other audits include registration and de-registration and irregular investigations.	
Audit Reports and Follow Up Procedures	Audit reports completed by officers are scrutinized by their line manager. Senior Managers examine visit reports on a spot check basis. Irregularities are followed up by a return visit to ensure compliance.	There is a standard audit report. Assessments are computer generated and automatically sent to the taxpayer. The mailing function is the responsibility of an outside contractor. The administrative personnel follow up the collections, and are responsible for the debt management procedures.		Audit report form includes information about the complexity and compliance points, and time take. This data is entered into VIPS.	Officers complete simplified summary report and a more detailed report for each visit. Additional forms are completed to update the computer system.	Audit reports are referred to supervisors.
Oversight Procedures for Field Audit	Managers have a program of unannounced overtaking visits.	The audit manager reviews a case and specifics. When essential steps had been omitted, the audit manager will refer the case back to the auditor to re-visit those aspects.	There is no program of physical management oversight. If wrongdoing is suspected, there is an option to use internal auditors to investigate.	Management checks are largely limited to desk checking. Some return visits might be made for specific reasons, but this is not a routine procedure.	Managers at senior inspector and Assistant Commissioner levels undertake indoor review of all visit report.	Not yet developed.
1.8.1 Organization of Debt Collection	The Debt Collection Unit services both VAT and Direct Taxes.	Debt collection and management is run by a separate unit within the branch offices and forms part of the administrative function. This function covers all type of taxes (VAT, PAYE, and income taxes).	There is a separate unit of 3 people dedicated to debt recovery for both customs and sales tax supervised by principal officer.	Headquarters has a small dedicated debt collection unit. Regional offices monitor their own VAT debt cases. Officers rely on manual oversight rather than ledger balance recorded on the VIPS.	The Debt Collection Unit (DCU) is now responsible for all types of taxes. The overall management of the DCU is the responsibility of an Assistant Commissioner who reports directly to the Commissioner of Finance.	Each region has its own integrated debt management/collection regime.

Table 9.1 VALUE ADDED AND SALES TAX ADMINISTRATION IN THE SOUTHERN AFRICAN DEVELOPMENT COMMUNITY *(contd)*

		Angola	Botswana	Dem. Rep. of Congo	Lesotho	Malawi	Mauritius	Mozambique
	Number of Tax Officers Dedicated to Debt Collection	No data available.	Four.	No data available. Tax Registrars are located in each directorate and external departments (CDI and CIS).	4 senior collectors and 6 collectors.	Sixteen personnel nationally.	9 officers.	No data available.
	Debt Enforcement Mechanisms	Local civil courts can order recovery, forced sale, or sequestration of assets. In the regions, the head of the tax office is usually also the local judge who would decide on tax assessment and debt cases.	Penalties and interests, demand notices, attachment of accounts, attachment of property.	25% penalty for failing to submit the tax returns in time. 10% fine for each month payment overdue. Notice to third parties (Avis à tiers détenteurs) for follow-up procedures.	LRA officers are authorized to seize and arrange auctions to sell goods, and have ability to secure monies by freezing bank accounts. Process for debt recovery: demand, final demand, seizure, and forced sale. Arrears can be written off only with the approval of the VAT Commissioner.	An officer or the police can carry out distraint on assets to recover the debt.	a. Computer generated notices on returns with short or no payment b. Letter requesting payment c. Attachment orders d. Distress warrants e. Contrainte f. Privilege of inscription	- A debt is notified manually to the DCU. - A demand notice is sent to the taxpayer. - When payment is not received, a distraint is instituted. An attachment to bank accounts can also be used. Debt legally expire after 15 years.
1.9.1	**Number of VAT/Sales Tax Fraud Cases Prosecuted per Year**	Tax fraud is administratively viewed as civil/financial matter. Failure to pay tax may result in civil proceeding for recovery. No criminal prosecution has been carried out.	Some cases (number of cases not available) have been sent to the Attorney General, but none has been prosecuted.	No data available.	Currently 10 cases are under investigation. No one has been prosecuted since VAT was introduced in July 2003.	No case on surtax fraud has been prosecuted thus far. Some criminal-type investigations are carried out by experienced auditors with the aim of imposing penalties rather than prosecution.	A criminal investigation is never carried out in practice. An in-dept audit is conducted in lieu of criminal investiga-tion.	Fraud cases have never been reported to the police for investigation. Cases of suspected fraud are dealt with as financial matters, which subject to penalties.
	Number of Cases of Administrative Penalties	No data available.	FY 2003: 12,282 instances for 4,834 taxpayers with the total amount of penalties P 46.4 million.	No data available.	Penalties are calculated automatically by the computer at 3% per month.		No data available. A surcharge of Rs 200 per day is charged for non rendering returns. Penalty is charged at 10% of arrears for the first month, and 2% for each additional month up to 100%.	No data available.

Table 9.1 VALUE ADDED AND SALES TAX ADMINISTRATION IN THE SOUTHERN AFRICAN DEVELOPMENT COMMUNITY *(contd)*

		Namibia	South Africa	Swaziland	Tanzania	Zambia	Zimbabwe
	Number of Tax Officers Dedicated to Debt Collection	13 officers for both VAT and Direct Taxes.	No data available.	Collection (enforcement): 3 Adjustment/queries: 3 Data capture: 10	No data available.	The DCU has an establishment of 28 dedicated officers for all taxes.	No data available.
	Debt Enforcement Mechanisms	- Final account is sent to the trader outlining the debt. - Manually issued reminder is issued 10 days later. - Second reminder is manually issued 10 days later, possibly with an investigation officer visit. - If financially viable, the State Attorney may be used to recover. This can include attachment of property and eventual forced sale. - Charges in connection with attachment and disposal are added to the debt. - Debts deemed to be irrecoverable are written off.	A 10% penalty is automatically raised for a late VAT payment. There is no penalty for a late return. Interest is chargeable on per month or part of a month basis. Demand notices and reminders are send out, reminders are sent out. Bank accounts and other debtors of the taxpayers can be attached. Debt judgment against the taxpayer also gives the taxpayer a bad credit record.	Monthly statements are printed on the government mainframe (customs office has terminals). Those with debts of more than 3 months are selected for recovery action. Interest at 2% per month can be added manually for late payments. Demand notices have been used, but ineffective. Attachment can also be used, but it is cumbersome and very slow. The main power used is to advise the borders to remove the deferment facility for defaulters, or refuse to clear new imports	The law provides for distraint and forced sale of assets and the freezing and sequestration of monies from accounts. However, the debt management units try to recover debt without recourse of these means.	- Immediate Demand Letter - Warrant of Distress - Auction (Forced) Sales - Garnishee Orders - Civil Suits - Charge on Land	No data available.
1.9.1	**Number of VAT/Sales Tax Fraud Cases Prosecuted per Year**	There is provision for prosecution for fraud but no case has been investigated to this standard. The Special Investigation Unit carries out in-depth audit rather than investigating criminal cases.	For FY 2002/3, 64 cases were prosecuted for fraud and evasion. A number of taxpayers and consultants have been jailed.	No data available.	A tax investigation unit is in place to cover all tax types. TRA has its own lawyers who run the prosecutions to their conclusion.		No data available.
	Number of Cases of Administrative Penalties	None compliance, such as failure to file returns and to keep proper accounts, are criminal offences. Approximately 400 criminal summonses have been issued. However, the Court has mostly referred these cases back to the Department. This appears to be a need for an option of non-criminal administrative financial penalties, with recourse to the courts for more serious cases of fraud.	The computer system automatically raises penalties for late payments. This statistics are not readily available. There is no administrative penalty for administrative offences (e.g., late filing, inadequate books, incorrect pricing).	No data available.	For FY 2003/2004, 36 cases were in the process of investigation. Of these, 24 have been settled by compounding, and 12 are in the court process.		No data available.

Table 9.1 VALUE ADDED AND SALES TAX ADMINISTRATION IN THE SOUTHERN AFRICAN DEVELOPMENT COMMUNITY *(contd)*

	Angola	Botswana	Dem. Rep. of Congo	Lesotho	Malawi	Mauritius	Mozambique
1.10.1 Levels of Appeal Open to Taxpayers under VAT/ Sales Tax	− The Head of Local Office − National Tax Directorate − Ministry of Finance − Administrative Court Note: In the regions, the head of tax office is usually also the local judge who heads the court/tribunal.	- Level 1: Director of Customs & Excise - Level 2: Board of Adjudicators - Level 3: High Court	Appeals can be lodged to the General Director of Taxes without the tax being paid.	Taxpayer may appeal to the VAT commissioner who may refer the matter to an appeals committee made up of 6 officers, including the Assistant Commissioner for Debt Management. A Revenue Appeal Tribunal will be established later in 2004 following the parliamentary approval.	Appeals go to an internal body made up of heads of sections, after which the Commissioner General is the highest level of appeal. The law has made provision for a tax tribunal, but this is not yet in place.	The first level of appeal would be the Objection and Appeal Section, which is set up under an Assistant Commissioner. After that, the process would be: - Objection to Commissioner - Appeal to Assessment Review Committee - Appeal to Supreme Court	Taxpayers may appeal to the senior officer at the tax office. If the decision is not accepted, taxpayers can be referred to an administrative court, which include the Head of the relevant tax office in the panel. There is no further appeal beyond this court.
1.11.1 Mechanisms for Educating New Taxpayers	Visits, workshops, and pamphlets.	Media (TV, radio, newspapers), booklets/pamphlets, seminars/workshops, visits to the VAT offices.	Media (TV, radio, newspapers) and pamphlets.	Media (TV, radio, newspapers) and leaflets. First audit includes heavy advisory component. LRA has established a well-resourced and accessible advice center with simple multilingual leaflets.	The headquarters has a Public Relation and Taxpayer Education Directorate. A good range of leaflets has been introduced, although some are in need of reprint.	- Educational visits (not very effective) - Workshops at office.	New taxpayers are provided with advice when they apply for registration.
Mechanisms for Educating Taxpayers on Changes in Laws, Regulations, and Procedures	Printed leaflets, newspaper advertisements, and seminars for affected sectors.	Media (TV, radio, newspapers), booklets/pamphlets, seminars/workshops, VAT Journal	The General Directorate provides an e-mail address for communication with the taxpayer. Public Service Division is responsible for disseminating information to the public. For more than five years, a TV program called *Taxation and Development* has been giving information about tax issues.	Media (TV, weekly radio show, newspapers) and leaflets/posters.	Media (TV, radio, newspapers), public rallies, and leaflets. New taxpayers are provided with basic education at registration.	Taxpayers are informed through: - Circulars - TV - Workshops - Canvassing campaigns - Leaflets - Websites	Media (TV, radio, newspapers) and leaflets.
Capacities and Strategies to Service Taxpayers	Four to five people are assigned in each local tax office to deal with taxpayer queries.	Dedicated office, dedicated telephone, immediate responses through e-mail and post, websites, workshops and seminars for accounting professions.		Telephone enquiries are taken by the dedicated advice center at the head office. The VAT Division has its own websites and e-mail service for enquiries.	Dedicated offices at the regions, a toll-free telephone line, and websites.	No dedicated office is setup to service taxpayers. Taxpayers are directed to a specific section which will answer their questions.	Toll free telephone for providing advice and information.

Table 9.1 VALUE ADDED AND SALES TAX ADMINISTRATION IN THE SOUTHERN AFRICAN DEVELOPMENT COMMUNITY *(contd)*

	Namibia	South Africa	Swaziland	Tanzania	Zambia	Zimbabwe
1.10.1 Levels of Appeal Open to Taxpayers under VAT/ Sales Tax	Appeals are made to the senior manager in the department, and to the Commissioner as the last resort. Taxpayers also have access to the Ombudsman to complain, but the Ombudsman cannot rule on assessments. There are plans to set up a process of appeal to a Special Tax Court.	Objections and appeals can be referred to a specially constituted tax board. This process is less formal than the tax court, and less costly for both the taxpayer and SARS. An Alternative Dispute Resolution (ADR) process has been introduced as a mechanism before the formal court proceedings are followed.	Businesses may appeal to the senior officer and the Commissioner, after which they may appeal to the Ministry of Finance or to the courts.	**Complaints** are dealt internally. Complaints can be made with regard to service quality and unfair treatment. **Appeals** are limited to decisions related to assessments and refusal to refund or register. There are two tiers of appeal: an Internal Appeal Board that hears initially; and Tax Revenue Appeal Tribunal. Appeals require payment of 50% of the tax in dispute.	**Internal Appeal**: The Commissioner General has the power to waive penalties and interest in part or in full. Appeals are decided accord-ing to the amount being appealed: - Sr. Inspector < K5 million - Asst. Commissioner < K 15 million - Deputy Commissioner < K 25 million - Commissioner > K 25 million **Revenue Appeal Tribunal**: An independent body appoin-ted by the Minister of Finance.	Taxpayers may raise an objection with the Commissioner General. Taxpayers can also appeal to Special Tax Court, then to the High Court and finally to the Supreme Court. Taxpayers also have an option to raise complaints with the Ombudsman.
1.11.1 Mechanisms for Educating New Taxpayers	Press releases in the news-paper, and the circulation of pamphlets.	VATNEWS is published at least twice a year. VAT guides are updated continuously. E-mail facilities are increasingly being used.	Field visit or inquiry by the taxpayers.	TRA has a Director of Taxpayer Education. For VAT, in the headquarters there is a taxpayer service officer who reports to the Director and VAT Commissioner. There is also taxpayer education staff in all regional offices. TRA has a toll free hotline for information and complaints, leaflets in English and Swahili, and websites.	- Educational Visits - On the Spot Advice - Booklets, Leaflets - VAT Knowledge Confirma-tion Form - to assess the taxpayer's knowledge prior to registration	ZIMRA has a well developed public information division. Information conduits include TV, radio, newspaper adverts, promotional gifts, billboards, and pamphlets.
Mechanisms for Educating Taxpayers on Changes in Laws, Regulations, and Procedures	Press releases in the news-paper, and the circulation of pamphlets.	VATNEWS and VAT Guide are distributed to all taxpayers. VATNEWS gives details of law amendments. The SARS website is regularly updated.	Radio, newspaper, and the Government Gazette.	Law changes may be published in weekly Gazette. Special booklet is produced to describe significant changes.	- Gazette Notices - Post Budget workshops to educate taxpayers on new changes - Weekly radio program known as The Taxman - TV and newspapers - Website www.zra.org.zm - Workshops	As above, plus the Government Gazette.
Capacities and Strategies to Service Taxpayers	A customer service center is in place in Windhoek. The Department is developing websites to cover its various activities.	Taxpayer service is mainly through the branch offices around the country. Comprehensive websites are available. A telephone line for reporting tax fraud is operating as well as for reporting corruption.	None.	Similar to educating new taxpayers.	ZRA has two Advice Centers dedicated to taxpayer services: one in Lusaka and one in Copperbelt.	Theres is a developed central office in Harare that coordinates for the whole country. There is no dedicated enquiry point in each office.

Table 9.1 VALUE ADDED AND SALES TAX ADMINISTRATION IN THE SOUTHERN AFRICAN DEVELOPMENT COMMUNITY *(contd)*

	Angola	Botswana	Dem. Rep. of Congo	Lesotho	Malawi	Mauritius	Mozambique
Website Content	Ministry of Finance: www.minfin.gv.ao Website in Portuguese.	Department of Customs and Excise: www.finance.gov.bw/vat/ − VAT Act and Amendments − VAT Regulations − VAT Guide/Practice Notes/ Brochures/FAQ − VAT Forms: Registration and Returns − Feedback/Contact Us	None.	Lesotho Revenue Authority: www.lra.org.ls − VAT Division Profile − VAT Acts and Regulations − VAT Brochure/FAQ/ Registration Info − Feedback	Malawi Revenue Authority: www.mra.mw − Basic descriptions about taxes	Ministry of Finance and Economic Development: ncb.intnet.mu/mof/department/ vat/ − Acts and Regulations − Registration Forms and Tax Returns − VAT Leaflets − E-Filing and E-Payment − Contact Us	None
1.12.1 Training Capacities/ Schools	No formal training school. Training is carried out in-house.	In-house training for new officers and refresher courses for existing officers.	The National School of Finance (ENF) provides training in taxation and customs. CEPETEDE, a private institution, provides training in taxation and accounting for employees and high ranking officers.	In-house training for new officers with follow up mentoring. Trainers are appointed in house, but consultants are also brought in.	MRA has its own training school. Three full-time surtax trainers were being trained.	The tax administration has an in-house training school.	DNIA has its own training school that provides a limited number of courses.
Courses Offered	Auditors receive up to one month of refresher training per year. The last refresher training on the petrochemical industry was given in 2002.	- VAT Law and VAT Audit - Introductory courses for new recruits - Basic and advanced courses to refresh officers	The ENF runs a 3-year training course, which curriculum includes a two-month internship at the DGI or Customs Office.	Basic VAT (4 weeks) VAT Act (2 weeks) Basic Audit (2 weeks) Advanced Audit (2 weeks) Computerized Audit (2 weeks)	Entry level introduction, including surtax. An advanced surtax curriculum is being developed to provide more focused skills at an advanced level.	Training offered includes basic- and advanced-level VAT courses, management and leadership courses, and general courses (e.g., computer).	A basic introductory courses for 2-3 weeks.
Use of External Training Facilities In-Country and/or Outside of Country	Tax administration personnel have attended SATI and SADC events. Financing and language limitations, however, are major hurdles. There is a push to raise the level of competence in English.	- Masters in Taxation - Australia - Advanced Taxation - Republic of South Africa	In-country: CEPETEDE Outside the country: One-year academic training at the *Ecole des Finances* in Paris with support from the French Government.	Tax Policy and Administration at SATI, University of Pretoria.	The use of external training is minimal due to cost constraints, although opportunities are taken such as SATI and other overseas training.		When opportunities arise, they are taken−but resources and language limitations minimize such opportunities.
II. STOCKS AND FLOWS OF VAT/SALES TAX							
2.1.1 Annual VAT/Sales Tax Collections − On Imports	No data available.	VAT FY 2002/3: 658.0 million FY 2003/4: 1,175.3 million	Turnover tax accounted for about 60-75% of the total revenues.	No data available.	Surtax FY 2001: K 3.6 billion FY 2002: K 3.9 billion FY 2003: K 5.3 billion	FY 2001: Rs 3.4 billion. FY 2002: Rs 4.1 billion. FY 2003: Rs 5.7 billion.	No data available.
Annual VAT/Sales Tax Collections − On Domestic Transactions	Consumption Tax FY 2001: 3.6 billion FY 2002: 12.3 billion FY 2003: 29.2 billion The first 4 month of 2004: 11.0 billion.	VAT* FY 2002/3: 434.5 million FY 2003/4: 853.0 million *Gross amount, include refund.	No data available.	No data available.	Surtax FY 2001: K 2.7 billion FY 2002: K 3.0 billion FY 2003: K 4.5 billion	FY 2001: Rs 2.5 billion. FY 2002: Rs 3.0 billion. FY 2003: Rs 4.2 billion.	No data available.

Table 9.1 VALUE ADDED AND SALES TAX ADMINISTRATION IN THE SOUTHERN AFRICAN DEVELOPMENT COMMUNITY *(contd)*

	Namibia	South Africa	Swaziland	Tanzania	Zambia	Zimbabwe
Website Content	Ministry of Finance: www.op.gov.na − Brief descriptions about the Ministry of Finance	South African Revenue Authority: www.sars.gov.za − National Budget − VAT Rulings & Regulations − VAT Forms − VAT E-Filing/Refund − Report a Suspicious − Contact SARS	None	Tanzania Revenue Authority: www.tra.gov.tz − Corporate Plan; Org. Structure − Tax Laws − Tax Revenue Statistics − VAT FAQ − Contact TRA	Zambia Revenue Authority: www.zra.org.zm − Practice Notes, Leaflets, Legislation, General Tax Info − Total Revenue Statistics − Contact Us	Zimbabwe Revenue Authority: www.zimra.co.zw − Budget Speech, Finance Bills, Public Notices, Archives − VAT Information/FAQ − VAT Forms − Contact Info Search Registered Operator
1.12.1 Training Capacities/ Schools	Training Division is responsible for the staff training. There is no training school in place. Training is provided on site.	Human Resource Division runs a training section that caters all tax types. A new SARS Academy is going to take over the training function.	Yes. Training is offered in three levels.	Tanzania has an Institute of Tax Administration.	ZRA used to have a fully-fledged training center. However, the center had suffered neglect in terms of investment. Training is now held on the second floor of the Revenue House in Lusaka, and in Nchanga House in Copperbelt.	ZIMRA has a highly developed internal training capacity.
Courses Offered	VAT Introduction Course for new entrants (2 weeks). VAT Audit Course for those new to audit work (2 weeks).	VAT related courses include VAT 1, 2, 3 each running 2-5 weeks. VAT recoveries and accounting are also offered. Training is an on-going process carried out throughout the year.	Entry Level: 5-week introduction (including sales tax) Mid Level: 5-week customs checking Advanced Level: 4-week tariff classification In-house lawyers receive specialist training.	Introductory courses for new staff. Short courses (1-4 weeks) for VAT officers.	Courses are classified into three categories: **Technical** − core training programs for improving tax inspection/collection performance. **Corporate** − this course is general in nature (e.g., communication skills, customer care, etc.). External training provider deliver the courses. **Computer** − computer training is provided by internal staff from the IT Department.	Training include 2-week technical course on VAT.
Use of External Training Facilities In-Country and/or Outside of Country	SATI and SADC seminars.	SARS has a bursary scheme that allows officers to further their studies in disciplines that complement the SARS business. From time-to-time. Study groups are arranged in other countries, and regional conferences are supported.	Opportunities are also taken to attend SATI and SADC training events, but funding is a challenge.	Short courses up to one month are conducted outside the country, normally for senior officers.	TRA frequently receives invitation to nominate staff to attend courses offered by CATA, SADC, COMESA, World Customs Organization.	ZIMRA makes use of executive development programs at the University of Zimbabwe, Harvard, and SAMI (South Africa). CATA, SADC, and SATI are also utilized.
II. STOCKS AND FLOWS OF VAT/SALES TAX						
2.1.1 Annual VAT/Sales Tax Collections − On Imports		FY 2001: R 26.1 billion. FY 2002: R 31.6 billion. FY 2003: R 37.7 billion.	No data available.	FY 2001: T.shs. 182.1 million. FY 2002: T.shs. 208.7 million. FY 2003: T.shs. 250.2 million.	FY 2001: K 492.1 billion. FY 2002: K 479.1 billion. FY 2003: K 649.1 billion.	**Import Tax**: FY 2001: $ 3.6 million. FY 2002: $ 3.8 million. FY 2003: $ 3.2 million.
Annual VAT/Sales Tax Collections − On Domestic Transactions	FY 2001/2: $ 1.9 billion. FY 2002/3: $ 2.2 billion. FY 2003/4: $ 2.4 billion.	FY 2001: R 28.4 billion. FY 2002: R 29.5 billion. FY 2003: R 32.4 billion.	No data available.	FY 2001: T.shs. 140.0 million. FY 2002: T.shs. 166.2 million. FY 2003: T.shs. 201.6 million.	FY 2001: K 685.9 billion. FY 2002: K 869.5 billion. FY 2003: K 1,036.1 billion.	FY 2001: $ 28.1 million. FY 2002: $ 71.9 million. FY 2003: $ 88.7 million.

Table 9.1 VALUE ADDED AND SALES TAX ADMINISTRATION IN THE SOUTHERN AFRICAN DEVELOPMENT COMMUNITY *(contd)*

	Angola	Botswana	Dem. Rep. of Congo	Lesotho	Malawi	Mauritius	Mozambique
2.2.1 **Composition of Arrears (self assessed, estimated, penalties and interest, etc.)**	No data available.	FY 2002/3: 46.1 million FY 2003/4: 124.1 million	No data available.	No data available.	Composition data is not available; arrears are manually recorded. The debt stock excluding parastatals is circa K 150 million. Parastatals owe about K 265 million.	Self-Assessed: FY 2001: Rs 28.4 million FY 2002: Rs 30.3 million FY 2003: Rs 44.4 million Official Assessment: FY 2001: Rs 94.2 million FY 2002: Rs 110.3 million FY 2003: Rs 237.1 million	No data available.
Months of Tax Arrears (Stock of Arrears / Average Tax Collections per Month)	No data available.	FY 2002/3: 0.7 months FY 2003/4: 1.6 months	No data available.	No data available.		FY 2001: 0.42 months. FY 2002: 0.51 months. FY 2003: 1.12 months.	No data available.
Concentration by Sector (Parastatal vs. Private)	No data available.	Parastatal FY 2002/3: 15.6% FY 2003/4: 2.1%	No data available.	No data available.		All debts relate to private sector.	No data available.
2.3.1 **Months of Credit Carry Forwards (Stock of Credits / Average New Credits per Month)**	No data available.	No data available.	N/A	No data available.	No data available.	FY 2001: 1.29 months. FY 2002: 0.96 months. FY 2003: 1.59 months.	No data available.
2.4.1 **Months of Refund Lags (Stock of Refunds in Arrears/Average New Refunds per Month)**	No data available.	FY 2002/3: 0.2 months FY 2003/4: 0.5 months	N/A	Refunds are paid monthly for taxpayers in a regular credit position (e.g., exporters) and quarterly for other taxpayers.	By law, refunds should be made within 1 month. In reality, the time may exceed 3 months.	FY 2001: 0.51 months. FY 2002: 0.67 months. FY 2003: 0.62 months.	No data available.
2.5.1 **Self Assessed and Declared Taxes**	No data available.		No data available.	No data available.	No data available.	FY 2003: Rs 3.0 billion.	No data available.
Additional Assessments Based on Audit of Books and Records	No data available.	FY 2002/3: 21.7 million FY 2003/4: 78.0 million	No data available.	No data available.	No statistics available. Special exercise estimated that in 2003 56 assessments producing additional tax of K 26.2 million.	FY 2003: 121 assessments for an amount of Rs. 92.8 million, exclusive of penalty.	No data available.
Additional Assessments Estimated without Audit of Books and Records	No data available.		No data available.	No data available.	No data available.	No data available.	No data available.
Penalties	No data available.	FY 2002/3: 0.7 million FY 2003/4: 46.4 million	No data available.	No data available.	No data available.	FY 2003: Rs 58.9 million.	No data available.
Interest	No data available.	FY 2002/3: 0.1 million FY 2003/4: 3.1 million	No data available.	No data available.	No data available.	Not applicable. There is no provision for interests to be charged.	No data available.

Table 9.1 VALUE ADDED AND SALES TAX ADMINISTRATION IN THE SOUTHERN AFRICAN DEVELOPMENT COMMUNITY *(contd)*

	Namibia	South Africa	Swaziland	Tanzania	Zambia	Zimbabwe
2.2.1 **Composition of Arrears (self assessed, estimated, penalties and interest, etc.)**	No data available.	Total VAT debt: FY 2001: R 11.8 million. FY 2002: R 14.6 million. FY 2003: R 21.1 million.	No data available.	No data available.	FY 2003: Total Arrears: K 128.9 billion Assessed Tax: K 35.8 million Penalties: K 66.4 million Interest: K 26.7 million	No data available. (VAT commenced on Jan 2004)
Months of Tax Arrears (Stock of Arrears / Average Tax Collections per Month)	No data available.	1-3 months: R 561,431 4-6 months: R 960,372 7-8 months: R 746,806 > 9 months: R 18,821,111	No data available.	No data available.	FY 2001: 1.8 months. FY 2002: 1.6 months. FY 2003: 1.5 months.	No data available.
Concentration by Sector (Parastatal vs. Private)	No data available.	No data available.	No data available.	No data available.	Parastatal FY 2002: 39.6% FY 2003: 37.2%	No data available.
2.3.1 **Months of Credit Carry Forwards (Stock of Credits / Average New Credits per Month)**	No data available.	No data available.	No data available.	No data available.	FY 2001: 0.04 months. FY 2002: 0.04 months. FY 2003: 0.04 months.	No data available.
2.4.1 **Months of Refund Lags (Stock of Refunds in Arrears/Average New Refunds per Month)**	Refunds are repaid in timely manner (normally within 21 days).	No data available.	No data available.	No data available.	FY 2001: 0.6 months. FY 2002: 0.4 months. FY 2003: 0.4 months.	No data available.
2.5.1 **Self Assessed and Declared Taxes**	No data available.	FY 2001: R 25.5 billion. FY 2002: R 25.6 billion. FY 2003: R 26.5 billion.	No data available.	No data available.	FY 2001: K 608.8 billion. FY 2002: K 651.4 billion. FY 2003: K 702.0 billion.	No data available.
Additional Assessments Based on Audit of Books and Records	No data available.	FY 2001: R 5.9 million. FY 2002: R 3.9 million. FY 2003: R 2.9 million.	No data available.	No data available.	FY 2001: K 199.0 billion. FY 2002: K 65.6 billion. FY 2003: K 13.1 billion.	No data available.
Additional Assessments Estimated without Audit of Books and Records	No data available.	No data available.	No data available.	No data available.		No data available.
Penalties	No data available.	No data available.	No data available.	No data available.	FY 2001: K 130.3 billion. FY 2002: K 84.9 billion. FY 2003: K 24.2 billion.	No data available.
Interest	No data available.	No data available.	No data available.	No data available.	FY 2001: K 51.6 billion. FY 2002: K 26.2 billion. FY 2003: K 9.4 billion.	No data available.

X. Conclusions and Recommendations

10.1 Conclusions

1. SADC Member States represent a very diverse set of countries in terms of general economic indicators as well as specific characteristics relevant to implementation of a VAT, in particular, or tax systems, in general. The countries vary significantly in size, per capita income, impacts of civil disturbances in recent decades, sizes of government, major sources of revenue, aid dependency, educational attainment, and sector and trade structures. A common feature, however, is a high degree of trade integration for the most southern mainland country members.

2. Given the focus in this study on taxes on consumption, it is noted that a number of countries have Gross National Disposable Income (GNDI) significantly above GDP due to a combination of net transfers and net factor income from abroad. GDNI is the basis for determining savings and consumption, and makes GDP a problematic proxy for estimating consumption levels in a country.

3. The relative size of governments in the SADC region is generally large by international standards and total revenues as a share of GDP are relatively high. VAT is important, particularly among most of the low-income members, but is not a dominant source of revenues. While VAT has emerged in recent decades internationally as a major player in world tax system, its introduction is even more recent within SADC. The first VAT started only in 1989 and three countries (Botswana, Lesotho and Zimbabwe) have introduced VAT since 2002. Three countries do not have VAT systems: Angola, DRC and Swaziland. DRC is planning to introduce a VAT in 2005. Swaziland also has a VAT under preparation.

4. The introduction of VAT has served different purposes in different countries. For most it has replaced existing broad-based sales tax systems in the search for more efficient tax collections, but without major increases in revenues. There are a couple of exceptions to this pattern. Botswana has switched from a narrow-based selective sales tax to a broad-based VAT with significant revenue implications. Mauritius has been systematically raising it s VAT rate and revenues as it has reduced its import duty rates and thereby its dependency on customs revenues.

5. Generally, with a few exceptions, countries will have difficulty using the VAT to deal with the major revenue challenges arising from government deficits, aid dependency and the formation of common markets. VAT rates in the region are generally already relatively high considering the low levels of efficiency of the VAT systems.

6. Standard VAT rates convergence has being happening: the range of standard rates has diminished over time. All are in the range of 10% to 20%, but most

cluster around 15%. Only Zimbabwe still has significant luxury VAT rates, while Swaziland has a luxury goods sales tax rate of 25%.

7. Significant diversity exists in the application of exemptions, zero rating and refunds across member countries. This creates a range of effective VAT rates as well as positive and negative protection. A VAT with wide ranging exemptions and poor refund payments starts to look like a turnover tax. This risks undermining the benefits of a VAT structure.

8. A number of countries have already exhausted the revenue potential of VAT through raising the standard rate.

   Countries with the lowest per capita incomes tend to have the weakest tax capacities and low VAT efficiencies, but highest VAT rates and most exemptions.

   This results in high price responsiveness of the effective VAT base to VAT rate changes, limiting scope for increases in revenue yield. Hence, there are significant potential revenue and efficiency gains from base expansions and lowering tax rates, especially through introduction of unified presumptive taxes below minimum turnover levels.

9. Most countries do have scope to increase yields through:

   a. Economic development and related structural changes that will expand effective tax base as formal and monetary sectors grow and per capita incomes and educational attainment rises.
   b. Minimization of official zero rating and exemptions
   c. Introduction of "unified" presumptive taxes below minimum threshold for compulsory VAT registration to expand effective base of domestic indirect taxation (see below) and raising the registration limits to reduce administrative burdens.
   d. Improved administrative and compliance efficiencies, particularly through computerization, including risk analysis.

10. In most SADC Member States imports form a high share of GDP. Most have trade deficits (generally large), but a few have trade surpluses. The importance of imports coupled with difficult domestic bases result in the collection of VAT being dependent on effective customs control and collection at border. In the context of forming a common market, where border controls are weak, to protect revenues VAT may need to be charged on internal exports with reconciliation of border VAT collections to ensure the revenues of the net importing countries (origin as opposed to destination system). SADC's planned economic integration will raise major challenges for its indirect consumption taxes. SADC countries will need to either maintain customs controls at the internal borders, or charge a compensating VAT on internal exports

11. Over the past two decades, SADC Member States have undertaken a range of tax reforms including strengthening their tax administrations. These have

included a range of organizational and systems reforms and building the capacity of the personnel. A significant range of tax administration capacities now exists among SADC Member States. Many have implemented "best practice" arrangements in many functions; but none in all areas.

12. Seven member countries have established semi-autonomous revenue authorities. Six countries have functionally organized tax administration covering the inland or domestic tax administration. At least one other country has partial functional organization of debt collections. To achieve improved service of large clients and more efficient tax control, Large Taxpayer Units (LTUs) have been established on a multi-tax functional basis in seven countries and a further two countries have LTUs within their major tax types. Interestingly, none of the thirteen SADC countries has all three of these organizational arrangements and only one country has none of them. **Importantly, there is still room for implementing and deepening functional organizations as well as expanding on client-oriented arrangements (including client needs evaluation) to enhance the cost-effectiveness of taxpayer service and enforcement.**

13. Generally, there is limited ability of tax administrations to report on performance measures relating to the cost effectiveness of tax administration. Only about half the countries reported any detail of the expenditures on tax administration. While most countries could report aggregate figures of total and active registered taxpayers, only half could give the distribution of VAT, sales or turnover taxes by the turnover of the businesses.

    Similarly, reporting of tax collections in manners that would assist management or revenue forecasting was not encouraging. Only seven countries could report the VAT, sales or turnover taxes collected at the border by customs rather than on inland transactions. Less than half could report tax arrears and only about a third could report details of the composition of arrears by age, source or type of assessment. Similarly, low frequencies of reporting were evidenced on amounts of VAT credits unpaid or VAT credits carried forward in countries that do not refund all VAT credits when earned. In part, this weak tax collection reporting arises as a result of most countries running parallel paper and computer systems which clearly removes the focus from the detailed management information that they should be able to extract from computerized tax administration systems.

14. While most countries have computer systems supporting customs administration, only a few have fully computerized customs clearance systems. Similarly, most countries have computer systems supporting their domestic VAT, sales or turnover tax administration, all countries still have paper returns and files, and most use the computer system for tax collection information rather than tax collection management. There is still significant scope for fully computerizing tax administration system.

15. The internet offers enormous scope for e-government including timely, accurate and cost-effective e-publishing of tax documents, e-filing of tax returns and e-payment of tax liabilities. Only two countries have websites that

support all three major functions. A further five have websites that make detailed tax documents available to the public, while the remainder have websites with limited summary information on tax authorities and tax compliance. Development of the use of internet-based communications with the tax-paying populations represents a major opportunity for implementing more cost effective tax administration and raising tax efficiency levels.

16. The review of the human resources in the tax administration of SADC Member States showed weaknesses in key areas where functional organization can be most effective such as tax policy, assessment and audit. Many countries showed low shares of personnel with university qualifications and other post secondary training specific to tax administration. Countries with revenue authorities reported improved ability to attract qualified staff, but still had difficulty in attracting or retaining top-level professionals. All countries had very small numbers of qualified accountants. The study did not produce any findings concerning more general skills, such as general management, information system management, public relations and communications, or policy analysis, which could be limiting the performance of tax administrations.

17. Nearly all countries report having some form of internal capacity to provide VAT or sales tax training, typically training for new recruits and some refresher courses. Only a few countries report having capacity to provide training in accounting and auditing. Small countries with small numbers of officers have greater difficulty in supporting training institutions. Most countries report making use of regional and international training opportunities, but also report limitations of language and funding.

18. Very few countries make use of the court system to prosecute tax frauds. Countries generally use administrative means to enforce tax compliance. The courts are used more frequently for tax appeals. Seven countries report having established some form of special tax court, tribunal or board to be the primary form of appeals against tax assessment and other administrative decisions. A further two member countries intend to establish such bodies.

19. Cost-effective field audits are a critical tool in achieving compliance under a self-assessed VAT, sales or turnover tax. Only one country reports using random risk-weighted audit selection techniques. Most countries report some structured audit selection system where all registered taxpayers are audited with different frequencies from once a year to once every five years based on some criteria such as turnover. Some countries include random selection in picking audit cases, but many still report subjective judgment as a basis for selection. Many countries view refund audits outside the general audit function and devote a disproportionate resource to these audits. Clearly, the lack of full development of computerized administration and a policy commitment to move away from manual selection limits the ability to use experience-based risk-weighted random audit selection procedures.

20. Most, but not all countries, report some management oversight mechanisms to control for quality and reduce corruption in the audit process. Most send out

auditors in pairs and use some form of management review of audit reports. Only a few countries report using follow up or overtake audits to check audit quality.

21. While there is significant room for strengthening tax administration in the SADC region, economic development status limits tax compliance through problems caused by large informal and agricultural sectors, low educational levels, limited capacity of the accounting professions, and similar factors.

22. With the growing and desirable trend towards establishing functional tax organizations, future reviews and studies of the status and potential reform strategies of tax administration should be conducted on a comprehensive basis to cover the administration of all domestic or inland taxes.

10.2. Recommendations

This report recommends a staged approach to develop a regional consumption tax structure over the medium-term. The early stages would involve the gradual establishment of a compensating CVAT structure with origin-based taxation of internal exports, maintenance of border controls, and a reconciliation arrangement sanctioned by international agreement. This could be initially tested either within SACU or across a subset of SADC countries. This structure could then be rolled out to all SADC Member States with VAT systems meeting required degrees of harmonization such that internal exports are subject to tax at either the domestic rate or a CVAT rate by the time the SADC common market is in place in 2012. Agreements need be reached about the degree of harmonization of VAT structures and rates within the SADC region. This would require Members States to introduce VATs over the medium term if they are to become part of a more open trading area that would be established among the countries involved in the roll out of a co-ordinated VAT system. The higher the degree of harmonization achieved among Member States, the more options are open (i) as to the final co-ordinated VAT system within SADC and (ii) the degree of openness of the internal trade borders that can be achieved. A high degree of harmonization would also allow a potential switch from a origin-based CVAT arrangement with revenue reconciliation to revenue pooling and sharing once the legal and institutional arrangements exist for managing a SADC revenue pool. Different partial pooling mechanisms are suggested for dealing with the issues of differential incentives and efficiencies in VAT domestic collections.

More specific recommendations that would both enhance the operations of VAT and tax systems generally within the SADC Member States in a co-operative fashion and also assist improve co-ordination of the VATs within SADC along a path, as just described above, are as follows:

1. **It is recommended that an early initiative be undertaken by SADC to confirm the share of import VAT that is a final tax by member countries, or alternatively, the share of final taxes that are derived from import VAT.**

Data available to date suggest that some 15% to 40% of final VAT could be collected at the border. This represents a significant share of VAT revenues that could be at risk and the fundamental motivation for changing the VAT treatment of internal trade within a common market where fiscal borders are weakened or eliminated. Unfortunately, direct evidence is not available from SADC Member States. Countries should be encouraged to collect and report:

a. Import VAT or VAT collected at the border by customs each fiscal year. While these records are available to the VAT authorities of all countries, all countries do not report them systematically.

b. Import VAT collected from registered and unregistered importers. This requires either self-declaration by the importer of his VAT registration status on import documents and/or the matching of importer identification numbers (usually a taxpayer identification number) with records of businesses registered for VAT.

c. Total input VAT deductions and the amount of these based on import VAT paid in a fiscal year. This requires domestic VAT returns to split input VAT deductions into those arising from import VAT paid and those arise from VAT invoices from domestic suppliers.

2. **It is recommended that an early initiative be undertaken to enhance SADC collection and administration cost information.**

Despite most SADC Member States maintaining computer-based systems for tax collection statistics, improvements are required in the maintenance and publication of statistics on:

a. the tax collections by source (including the identification of tax collections from enforcement actions), and

b. stocks of tax arrears, refund obligations and tax credit carry forwards (in countries which do not refund all outstanding credits) by type.

This would increase the transparency of the tax systems, allow for improved management of VAT enforcement and credit refunds, and allow for more accurate forecasting of revenue collections. To achieve enhanced reporting would require changes in the coding of data collection the computer systems. Another area of weakness in reporting is on the cost of tax administration, especially in terms of breaking down costs by tax type and by tax function to estimate the unit costs of collection.

Additionally, it is recommended that consideration be given to a co-operative SADC-wide project to develop best practice advice for SADC Member States on tax collection data coding and reporting as well as for reporting unit costs and other performance measures of tax administration from computerized tax collection and budget systems.

3. **It is recommended that to improving tax efficiency and revenue growth prospects SADC introduce or expand the use of unified presumption taxes below minimum turnover levels for VAT registration for unincorporated businesses in place of VAT and income tax**

   Base restructuring is required to expand domestic tax bases, harmonize rates and reduce major distortions from exemptions and speed up refunds. Given the low tax efficiencies of the VAT and sales taxes, this would be an important innovation aimed at expanding the tax base. *Ad valorem* turnover taxes should be charged on small businesses and unit taxes on micro businesses. The administration of these taxes should be by local authorities in coordination:

   a. with general businesses licensing arrangements, and

   b. with central revenue authorities for taxpayer identification numbering and reporting.

4. **It is recommended that a co-operative project should be undertaken to review existing e-governance techniques in the region and to advise SADC Member States on the development and use of e-governance techniques, at a minimum in the area of e-publishing and effective communication with the tax paying population**

   VAT is a self-assessed tax. Information should be readily available to the taxpayer. Indeed the VAT legislation, regulations, guidelines, and other information notices should be readily available not only to the taxpayer but also to prospective international traders and investors in a country and officials of other member countries. SADC has made an effort to establish a Tax Database that includes tax legislation for all SADC Member States. This information is, however, partial and static. Completion of this study had to expend considerable resources to collect basic VAT system information. Currently, revenue authorities in seven member countries maintain up to date websites giving all relevant current VAT information**.**

   This would benefit national taxpayers, international investors and traders as well as SADC efforts at tax cooperation and coordination. The information content of web sites should also be available in other formats (such as printed documents) nationally for those who do not have access to internet services. Internet-based reporting of economic and tax collection performance data should also be encouraged. An extension to this project could be the provision of technical assistance on:

   a. the legal environment necessary to use the internet for e-filing and e-payments of taxes, and

   b. technical issues involved in introducing e-filing and e-payments.

5. **It is recommended that a SADC project be undertaken to accelerate the development of functional tax and VAT administration capacity.** This study should go further than the current study by undertaking a *combined*

assessment of strategies that countries could undertake to migrate to functional organizations, and assessment of the training needs and delivery capacities of member countries, especially where human resource constraints are limiting computerization, introduction of e-governance, and functional organization

International experience is showing that the functional organization of tax administration offers opportunities to gain more effective use of scarce administrative resources, significantly more effective auditing and debt enforcement, and opens the door to providing more differentiated and targeted taxpayer services, such as through a Large Taxpayer Unit (LTU). Preparatory to undertaking effective functional organization are the introduction of supportive tax legislation, understanding of the status of the overall tax system, and the training of personnel**.** This requires:

a. Review of tax administrations on a comprehensive basis rather than individual tax-type basis.

b. Member countries either review and co-ordinate their administrative provisions across existing tax type legislation or introduce a comprehensive tax administration law for all domestic tax types.

c. Training of tax officers in all relevant types of tax legislation, policy and procedures.

d. Training in modern tax administration strategies and methods as well as key skills such accountancy and audit, and information system management.

e. Development of cost-effective training capacity within the region.

The training considerations should go beyond accounting, auditing, tax legislation and tax system implementation, and should also look at weaknesses in management, project implementation, tax policy analysis, revenue forecasting and communications capacities.

The training strategy should advise on:

(i) where regional training (for all or part of SADC region) for routine tax administration activities (whether at an introductory or more advanced level) makes sense taking into account gains in economies of scale, but limited by country differences such as language, and

(ii) where regional or international training should be used to develop trainers, innovators and leaders in the tax systems at middle and high levels. These types of training are enhanced by deeper, broader and more comparative approaches to education such that both the range of approaches and practices in different countries are studied along with the critical analysis of why they do or do not work in different country contexts.

The study should assess existing regional training capacities or centers, address the costs of training and professional education, and identify mechanisms for financing regional training centers. The study could also address the roles of the professional

organizations, especially for the accounting profession, in training and development of the tax systems within member countries.

In the interim, prior to establishing any regional training institutions, it may be cost-effective for SADC to recruit a training coordinator to assess common country training needs, identify training resource persons, and co-ordinate the financing and organization of training facilities for an annual program of short-term training programs for Member States.

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Tax administration survey of SADC Member States

Appendix A: New SACU Revenue Sharing Formula

The 2002 SACU Revenue-sharing formula of SACU

The revenue sharing formula of the 2002 SACU Agreement, for a given financial year, is:
Ri = C (Ai/A) + (0.85) E (GDPi/GDP) + 20*(0.15) E (1-((Yi/Y)-1)/10)
where:

Ri	=	revenue share of SACU country i;
i	=	Botswana, Lesotho, Namibia, South Africa or Swaziland;
C	=	all customs duties actually collected on goods imported into SACU, less the cost of financing the Secretariat, the Tariff Board, and the Tribunal, less the customs duties rebated or refunded;
Ai	=	c.i.f. value (at the border) of imports of SACU country i from all other SACU members, less re-exports;
A	=	total c.i.f. value (at the border) of intra-SACU imports, less re-exports;
E	=	all excise duties actually collected on goods produced in the SACU area, less the cost of financing the Secretariat, the Tariff Board, and the Tribunal, less the excise duties rebated or refunded;
GDPi	=	Gross domestic product of SACU country i;
GDP	=	total gross Domestic product of SACU members;
Yi	=	Gross domestic product per capita of SACU country i;
Y	=	average gross domestic product per capita of all SACU members.

After some algebraic manipulations, Ri becomes:

Ri = C (Ai/A) + (0.85) E (GDPi/GDP) + (0.3) E (11- Yi/Y)

The customs component: C (Ai/A)

The pooled customs revenue will be distributed according to intra-SACU imports. On the basis of 1998/99 trade, South Africa would have contributed about 80% to the customs component, and its share of this component would have been 20.5% (in 1998/99 South Africa's intra-SACU imports were R7,520 million, while total intra-SACU imports amounted to R36,706 million). On the same basis, the BLNS would have contributed around 20% to the customs component, and their shares of the customs pool would have been: Botswana (26.6%), Lesotho (13.4%), Namibia (24.9%), and Swaziland (14.6%). These shares are expected to remain stable over time, though the size of the customs pool (C) will depend upon the value of imports and changes to the SACU tariff regime.

The excise component: (0.85) E (GDPi/GDP)

The size of the excise component has been set initially at 85% of the excise pool, and will be distributed on the basis of the GDP of each of the SACU countries. In 1998, South Africa's GDP represented 92.8% of SACU's total GDP, and its share of this component would have been 78.9% (92.8 times 0.85). The remainder of the 85% of the excise component would have been distributed as follows: Botswana (3.0%), Lesotho (0.5%), Namibia (1.8%), and Swaziland (0.8%).

The development component: (0.3) E (11- Yi/Y) = (0.15){1/5 – 1/50(Yi/Y-1)}100

The size of the development component has been set initially at 15% of the excise pool, and will be distributed inversely to each country's GDP per capita: the smaller the GDP per capita, the greater the share of the development pool. In 1998, GDP per capita in the SACU area was: Botswana (R17,968), Lesotho (R2,395), Namibia (R9,615), South Africa (R17,578), and Swaziland (R7,024); this leads to an average GDP per capita of R10,916. On this basis, the 15% share of the development component would have been distributed as follows: Botswana (2.80%), Lesotho (3.23%), Namibia (3.04%), South Africa (2.82%), and Swaziland (3.11%).

The composition of SACU payment by component:

On the basis of the previous figures, the BLNS countries would largely derive their total SACU revenues from the customs component: Namibia (83.7%), Botswana (82.1%), Swaziland (78.9%), and Lesotho (78.2%); while South Africa would receive 20.1% from this component. South Africa would get the majority of its SACU revenue from the excise component (77.2%), followed by Botswana (9.3%), Namibia (6.1%), Swaziland (4.3%), and Lesotho (2.9%). The development component is relatively more important for Lesotho and Swaziland (18.9% and 16.8%, respectively, of their total SACU revenues), followed by Namibia (10.2%), Botswana (8.6%), and South Africa (2.7%).

Source: SACU Agreement 2002, and DTI (2001).

Table A.1 SACU revenues, composition and distribution, 1989/90 - 2000/01

(Rand millions)

	1989/90	1990/91	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03	Average 96/97-00/01
Customs duties	2,194	2,502	2,736	2,961	3,413	4,247	5,326	6,518	6,067	5,986	6,518	7,854	8,632	9,500	
Import surcharges	2,625	2,075	1,456	1,521	1,756	1,171	457	(6)	(1)	2	0	-	1	1	
Specific excises	2,578	2,889	3,360	4,100	4,628	5,431	6,075	5,912	7,426	8,053	8,886	9,127	9,797	10,282	
Ad valorem excises	264	456	465	336	339	373	400	719	582	519	584	694	776	1,020	
SACU pool	7,661	7,922	8,017	8,918	10,136	11,222	12,258	13,143	14,073	14,559	15,989	17,674	19,206	20,803	
Total excises	2,842	3,344	3,825	4,436	4,967	5,804	6,475	6,631	8,007	8,572	9,470	9,820	10,573	11,302	
Excise share	37.1%	42.2%	47.7%	49.7%	49.0%	51.7%	52.8%	50.5%	56.9%	58.9%	59.2%	55.6%	55.1%	54.3%	56.2%
BLNS payments	1,366	1,801	2,760	2,984	3,089	3,249	3,890	4,363	5,237	5,577	7,197	8,396	8,205	8,259	
BLNS share of SACU pool	17.8%	22.7%	34.4%	33.5%	30.5%	29.0%	31.7%	33.2%	37.2%	38.3%	45.0%	47.5%	42.7%	39.7%	40.2%
Botswana	458	676	1,049	1,342	1,105	939	1,084	1,156	1,497	1,662	2,551	2,986			
	6.0%	8.5%	13.1%	15.0%	10.9%	8.4%	8.8%	8.8%	10.6%	11.4%	16.0%	16.9%			12.7%
Lesotho	264	355	424	548	747	841	907	1,006	1,173	1,033	1,183	1,126			
	3.4%	4.5%	5.3%	6.1%	7.4%	7.5%	7.4%	7.7%	8.3%	7.1%	7.4%	6.4%			7.4%
Namibia	448	559	946	735	782	902	1,156	1,349	1,560	1,805	2,241	2,877			
	7.1%	11.8%	8.2%	7.7%	8.0%	9.4%	10.3%	11.1%	12.4%	14.0%	16.3%	13.8%			13.5%
Swaziland	196	211	342	359	455	567	744	852	1,007	1,076	1,222	1,407			
	2.6%	2.7%	4.3%	4.0%	4.5%	5.1%	6.1%	6.5%	7.2%	7.4%	7.6%	8.0%			7.3%
South Africa	6,295	6,121	5,257	5,934	7,047	7,973	8,368	8,781	8,825	8,982	8,791	9,278			
	82.2%	77.3%	65.6%	66.5%	69.5%	71.0%	68.3%	66.8%	62.7%	61.7%	55.0%	52.5%			59.7%
South Africa share of GDP	93.6%	93.4%	93.6%	93.6%	93.6%	93.4%	93.4%	93.1%	92.9%	92.6%	92.3%	91.9%			92.6%

Appendix B.
Exempt and zero-rated items and persons

For countries with VAT systems

Under a credit-method VAT, the distinction between exemptions and zero-rating is critical. Production of exempt goods and services means that a business does not have to register, does not collect output VAT, and most importantly, does not qualify for input VAT deductions or credits. Zero rating by contrast is treated as a positive tax arte and businesses are required to register, not collect output VAT, but qualify for input VAT deductions and credits. In the case of import VAT, there is no effective distinction between exemption and zero rating. In both cases no import VAT is charged. Some countries focus their classification of exemptions and zero-rating on domestic supplies and purchases of specified or privileged persons and then have imports follow these classifications. Others will limit zero rating to domestic supplies and only exempt imports. This means that special arrangements have to be made for refund of VAT on domestic purchases by privileged persons such as diplomats and aid agencies.

The following tables list the exempt and zero rated goods and services, imports and supplies, and persons with special privileges with respect to VAT purchases, as the case may be for each SADC Member State.

Botswana (2002)

Type of exemption or zero rating	Reason	Items
Exempt supplies	Exemption	Financial services. Education services. Leasehold land by way of lease. Residential rental. Prescription drugs and services in a public medical facility.
	Scope clarification	Any goods or services by the State, a local authority or an association not for gain. Services to members of an association by the association. Accommodation supplied by the employer to the employee as a benefit of employment.
Zero-rated supplies	Structure of tax	Exports of goods and services. International transport services. Sale of a going business between registered persons. Petrol, diesel and eliminating paraffin (subject to excise duty)
	Policy	Sorghum or maize meal. Goods or services supplied for the personal or official use of the President or any dependent member of the President's family.
Exempt imports	Structure of import duty	Normal items exempt from import duty such as used/personal goods of changing residents or passenger baggage, temporary imports/exports, transit, reusable containers, inputs into production of exports, etc
	Policy	Minimum allowances on personal gifts and purchases Diplomatic and aid agency official imports (can apply for refunds on domestic purchases) Charitable and welfare organization imports. Disaster and emergency relief imports.

Lesotho (2003)

Type of exemption or zero rating	Reason	Items
Exempt supplies	Exemption	Public postal services Passenger transportation Medical and dental services Financial and insurance services Educational services Unimproved land Leasing or letting of immovable property by manufacturer, or for low-income housing schemes Residential housing property sales or rentals Hostels and boarding establishments Water (piped)
	Uncertain	Non professional sports organizations and activities Not for profit cultural activities Charitable organizations and activities
Zero rated goods and services	Structure of tax	Exports
	Policy	Maize meal, maize grain, sorghum meal, unmalted sorghum grain, wheat flour, wheat grain, bread, milk, beans, peas, lentils, agricultural inputs (fertilizers, seeds and pesticides), livestock and poultry feed, paraffin for cooking, illuminating or heating.
Exempt imports	Structure of import duty	Items normally exempt from import duty such as used/personal goods of changing residents or passenger baggage, temporary imports/exports, transit, reusable containers, inputs into production of exports, etc
	Policy	Minimum allowances on personal gifts and purchases Diplomats, heads of state Relief supplies

Malawi (2003)

Type of exemption or zero rating	Reason	Items
Exempt goods	Exemption	Live animals Animal products (meat, fish, dairy, etc) Unprocessed vegetable products excluding cut flowers, including malts and starches Fuel wood Untreated water Petroleum products Insecticides, herbicides, fungicides Books and newspapers Mosquito nets Coin Spraying equipment Tractors, ambulances Medical equipment
	Structure of import duty	Items normally exempt from import duty such as used/personal goods of changing residents or passenger baggage, temporary imports/exports, transit, reusable containers, inputs into production of exports, etc
Exempt services	Exemption	Educational services Banking and insurance services Postal services Funeral services Transport of exports
Zero rated goods and services	Structure of tax	Exports, including ships and aircraft stores
	Policy	Pharmaceuticals Medical Services Fertilizers Condoms Agricultural, horticultural and forestry machinery Food processing machinery Manufacturing equipment for pulp and paper, printing, textiles, clothing, leather and footwear, metal and metal working, wood working, rubber and plastics, tobacco product and vegetable oil sectors Motor vehicles for goods transport

Mauritius (2003)

Type of exemption or zero rating	Reason	Items
Exempt goods	Exemption	Unprocessed agricultural and horticultural produce, other than horticultural exports Primary agricultural and horticultural produce, other than vegetables and fruits produced in and exported from Mauritius and bird's eggs in the shell Animal or vegetable fats and oils other than ghee produced in Mauritius and edible oils Live animals for food production excluding poultry Fish (excluding fresh, chilled or frozen fish, the produce of Mauritius, and canned tuna, smoked fish and processed fish produced in and exported from Mauritius) Meat (excluding meat of poultry) other than canned meat produced in and exported from Mauritius, meat offal (excluding offal of poultry) Bird's eggs in the shell Buttermilk and cream (other than sterilized liquid milk), buttermilk, whey, kephir and other fermented or acidified milk and cream; cheese and curd. Rice, wheat, cereal flours (excluding wheat flour), bread. Molasses Soya bean protein Coffins Herbicides Green houses and related equipment Pharmaceuticals and antibiotics Kerosene including kerosene jet type fuel Invalid carriages Journals and periodicals Aircraft, ships, fishing vessels Works of art, collectors' pieces and antiques
Exempt imports	Structure of import duty	Items normally exempt from import duty such as used/personal goods of changing residents or passenger baggage, temporary imports/exports, transit, etc
	Exemption	Common salt
Exempt services	Scope clarification	Specified fee paying sporting events Cargo handling services in respect of goods transported by sea or air in international trade
	Exemption	Financial services Educational and training services Transport of passengers by public service vehicles excluding contract buses for the transport of tourists and contract cars. Medical, hospital and dental services including clinical laboratory services, services provided in a health institution and veterinary services Postal services Renting of fixed telephone lines Internet provider services Burial and cremation services Sales and rental of land and residential property Construction of residential property Aircraft leasing
Zero rated goods and services	Structure of tax	Exports of goods excluding exempt goods but including vegetables and fruits, horticultural produce,

		pharmaceuticals, antibiotics Export of services International transport of passengers and goods by sea or air Duty free shop supplies Supplies (other than exempt items) to free port activities and imports into export processing zones (except capital equipment subject to 5% where supplies to local market within last 3 years)
	Policy	Wheat flour, wheat bran, edible oils, margarine, sterilized liquid milk, curdled milk and cream, yoghurt Common salt Fertilizers, animal feeding stuffs other than prepared pet foods Printed books, booklets, brochures, pamphlets, leaflets and similar printed matter (except directories and reports), children's picture, drawing or coloring books music, printed or in manuscript Electricity and related services supplied by the Central Electricity Board Water and related services supplied by the Central Water Authority and for irrigation Supplies by Wastewater Management Authority Services supplied by holders of global business and certain banking licenses
	Import protection	Ghee produced in Mauritius Fish, fresh, chilled or frozen, the produce of Mauritius Common salt

Namibia (2003)

Type of exemption or zero rating	Reason	Items
Exempt supplies	Scope of tax	Fringe benefits to employees Trade union member services
	Exemption	Interest and margin-based financial services Financial intermediation services by a buy-aid society or a medical-aid fund Condominium management services Medical or paramedical services Hospital and similar health services Education services Land or building rentals for residential purposes accommodation or rental as employed housing allowance Public transport services Used goods (including vehicles) Goods and services to the Heads of State of foreign states
Zero rated goods and services	Structure of tax	Exports and supplies to EPZ International transport services Supply of services for land and land development outside Namibia, Services provided for temporary imports, Repair and maintenance of foreign bound aircraft or ship; Supply of services to non resident for ancillary transport within Namibia; Services related to international property rights for use outside of Namibia; Supply of telecommunication services for use by non resident Supply of parts or service w.r.t guarantee agreement Charitable organizations and children's homes, orphanages or old-age homes;
	Policy	Postage stamps (except collectors items); Mahango, mahango meal, maize meal Electricity, water, and sanitation residential services, Petroleum products (unleaded and leaded petrol, distillate fuels, kerosene and lubricity agent mixtures) Purchases by diplomats, international agencies and technical assistance subject to privileges and exemption certificates (S40)
Exempt imports	Structure of import duty	Items normally exempt from import duty such as used/personal goods of changing residents or passenger baggage, temporary imports/exports, transit, goods for use in EPZs, urns, wreathes, coffins and human remains, Unsolicited gifts, as subject to SACU agreements, unprocessed fish catches etc

	Policy	For use in mining or prospecting for natural oil or gas; Goods and services for humanitarian relief, under a technical agreement or as part of a multilateral agreement; Goods for Heads of State, Diplomatic and Foreign Representatives, Welfare or charitable purposes

South Africa (2003)

Type of exemption or zero rating	Reason	Items
Exempt supplies	Exemption	Financial services Passenger transport by road and rail Rental of residential accommodation and land Public or publicly recognized education services State provided medical services and medicines Supplies by employee organizations to members funded by membership contributions Condominium management services funded by levies
	Scope of tax	Supply by not-for-profit association of services or goods containing or produced from 80% by value of donated goods
Zero rated goods and services	Structure of tax	Exports of goods and services International transport
	Scope of tax	State subsidies and donations to welfare organizations Transfer payments made by public authorities to vendors
	Policy	Goods for agricultural, pastoral or other farming purposes Certain basic foodstuffs: brown bread, brown wheaten meal, maize meal, samp, mealie rice, dried mealies, dried beans, rice, lentils, fruit and vegetables, canned pilchards and sardines, milk (liquid, cultured, powdered), cooking oil, eggs, legumes and pulses, blended dairy powders Petrol, diesel (subject to excises and levies) and illuminating paraffin Gold coins
Exempt imports	Structure of import duty	Items normally exempt from import duty such as used/personal goods of changing residents or passenger baggage, temporary imports/exports, transit, packing containers, urns, wreathes, coffins and human remains, , as subject to SACU agreements, etc Travellers Cheques and Bills of Exchange
	Policy	Goods zero rated above: food items, petroleum products, etc Imports for technical assistance or disaster relief Printed promotional materials on tourisms and exhibitions in foreign countries Goods for Heads of States, Diplomats and other Foreign Representatives Unsolicited gifts to public or local authorities, and not-for-profit associations (for use in educational, religious or welfare purposes)

Tanzania (2003)

Type of exemption or zero rating	Reason	Items
Exempt supplies and imports	Exemption	Food, crop and livestock supplies (not for catering) Pesticides and fertilizers[a] and agricultural implements Approved pharmaceuticals Approved veterinary drugs and equipment[a] Aviation spirits Aircraft, including parts and maintenance Water (other than canned/bottled) Postage stamps[a] Fishing gear Computers, printers, parts and accessories and cash registers[a] Locally processed yarn[a] Packing material for milk processing and manufacture[a] Educational supplies (including capital goods to government-registered establishments), Medical, health and veterinary services Books and newspapers Sale and lease of housing and land Financial and insurance services Funeral services Tourism services Public transport services (excluding taxis, rental cabs and boat charters) Betting and gaming services (subject to selective tax) Equipment for mining sector activities For diplomatic missions For aid funded technical assistance For armed forces and armed forces duty free shops[a] For charitable, religious, community based non-profit organization for specified public purposes For public institution or non-government organization receiving government subventions and agreement for relief from taxation
Zero rated goods and services	Structure of tax	Exports of goods and services Supply to outgoing ships/aircrafts for consumption or duty-free sale Agricultural supplies to co-operatives intended for export International transport and ancillary services
	Policy	Locally produced medicines, drugs and equipment.
Exempt imports	Structure of import duty	Deceased or travelers personal effects, Duty free shops;
a. Under Second and Third Schedules only supplies are specified for qualifying for exemption or relief.		

Zambia (2003)

Type of exemption or zero rating	Reason	Items
Exempt goods and services (domestic supply or import)	Exemption	Public water and sewerage supply services; other than canned/bottled water Food, crop and livestock supplies and products, dairy products, fish and infant foods Pesticides and fertilizers Domestic kerosene Gold bullion Treated and untreated mosquito nets Pharmaceuticals and medical equipment Medical supplies to the blind and disabled Books and newspapers, maps and charts Health and medical services Equipment for blind and handicapped Educational services (public, not for profit, charitable) Transport services (bus, boat, air or rail) Financial and insurance services and trading in shares Funeral services Conveyance of real property Sale and lease of housing and land Charges or royalties for exploitation of natural resources Betting and gaming services Trade union subscriptions, but not goods and services financed by subscriptions
Zero rated goods and services	Structure of tax	Exports and related supplies, Transportation and transit and ancillary services related to exports Duty free shops
	Policy	Aviation kerosene Basic unprocessed foods including milk, fish, animal products, infant foods Agricultural produce Medical supplies Building supplies for charitable organizations Supplies to privileged persons (President, diplomats, donors, aid funded technical assistance, etc) Hotel accommodation in Livingstone, Raw materials for mosquito nets manufacture Specified tourist activities Imports for the President, Imports and supplies to aid funded activities, the diplomatic corps
Exempt imports	Structure of import duty	Items normally exempt from import duty such as used/personal goods of changing residents or passenger baggage, temporary imports/exports, transit, packing containers, urns, wreathes, coffins and human remains, aircraft stores in international transport, etc
	Policy	For charitable and religious organization activities Items imported under Investment Certificate

Appendix C
Final VAT collections:
What share comes from import VAT?

Imports and the collection of indirect taxes on imports form a key source of revenues in SADC Member States. In the case of VAT collected on imports a significant share of the VAT becomes deductible input VAT, but a large share remains a final VAT collection. As such border collections by customs services become a critical front line point of collection. It is therefore of importance to estimate the share of final VAT collections that are derived from import VAT collections.

Revenues from a credit-method VAT using the destination principle are derived effectively from two bases: (i) final consumption by the private and government sectors, and (ii) purchases of inputs by VAT exempt businesses. The non-deductibility of input VAT by exempt businesses effectively increases the VAT base beyond that afforded final consumption. Exempt businesses (such as exempt financial institutions, farmers or small businesses outside of the VAT net) produce intermediate inputs into other businesses producing VATable goods and services for final consumption. Essentially, the VAT on the inputs to these exempt businesses results in double taxation or tax cascading within the VAT system.

A destination VAT is collected on imports and on domestic transactions. Many imports are capital or intermediate inputs into domestic production and as a result the import VAT is potentially deductible. Much of the import VAT is final as it goes directly into final consumption or is not deductible by exempt businesses or the importers are outside the scope of the VAT. The issues in analyzing import and domestic VAT collections to determine the source and amount of final VAT collections are the same: basically there is a need to identify the shares of import VAT and domestic output VAT that are (i) VAT on final consumption, (ii) VAT on exempt business inputs, and (iii) input VAT that will be deducted by or refunded to a domestic business. Assume that import VAT (R_{imp}) forms a share λ of the total VAT collections, and that a share γ of the import VAT is deductible as input VAT and a share δ of output VAT on domestic supplies (R_{dom}^{output}) is deductible as input VAT, then

the total VAT collections (R) in a year, which is composed of domestic VAT (R_{dom}) and import VAT (R_{imp}), can be restated as follows:[101]

$$R = R_{dom} + R_{imp} \quad \textbf{(1)}$$

$$= R_{dom} + + \lambda R \quad \textbf{(2)}$$

$$= [\, R_{dom}^{output} - R_{dom}^{input} - R_{imp}^{input} \,] + R_{imp} \quad \textbf{(3)}$$

$$= [\, R_{dom}^{output} - \delta R_{dom}^{output} - \gamma R_{imp} \,] + R_{imp} \quad \textbf{(4)}$$

$$= R_{dom}^{output} (1 - \delta) + R_{imp} (1 - \gamma) \quad \textbf{(5)}$$

Now, $R_{dom}^{output} (1 - \delta)$ is the portion of output VAT that is the VAT on final consumption and on exempt business inputs. These are final, non-deductible and non-refundable VAT collections. Similarly, $R_{imp} (1 - \gamma)$ is the portion of import VAT that is composed of VAT on final consumption and exempt business inputs. Therefore,

$$R = R_{dom}^{final} + R_{dom}^{ebi} + R_{imp}^{final} + R_{imp}^{ebi} \quad \textbf{(6)}$$

$$= R_{dom}^{combined\ final} + R_{imp}^{combined\ final} \quad \textbf{(7)}$$

$$= R_{dom}^{combined\ final} + \lambda (1 - \gamma) R \quad \textbf{(8)}$$

$$= R^{final} + R^{ebi} \quad \textbf{(9)}$$

In practice, λ, the share of import VAT collections out of total collections is known for most, but not all countries with VAT systems. This typically falls in the range of 50% to 70% of total VAT collections. For example, import VAT in South Africa is about 50% of total VAT, while in Malawi, Mozambique, Tanzania and Zambia, it has been around 60% in recent years (2000-2002), generally rising from around 50% in earlier years.[102] Early data from the new VAT in Botswana show about 70% of the VAT collected on imports. The share of import VAT that becomes deductible as input VAT, however, is not so commonly known. A recent study in Ghana was able to determine this figure in that country where approximately 60% of the import VAT was deductible during 1999-2001 based on the import VAT reported as input VAT

[101] In this analysis it is assumed that VAT accruals and collections (or refunds) are equal. This means that there are no arrears in the collection of positive VAT and all accrued refunds are paid.
[102] The use of VAT deferrals on capital equipment imports in Zambia and VAT exemptions for mining sector and government purchases in Tanzania would serve to depress the share of VAT collected on imports.

deductions on VAT returns.[103] The share of import VAT in Ghana over these years average around 70%. Hence, the share of import VAT that was a final (or non-deductible) collection was 40% of the import VAT or nearly 30% of the total VAT. This indicates that collection of VAT at the borders on imports is a very important component of VAT collections. The deductible share of the import VAT is not typically known unless VAT returns report the value of import VAT claimed as input VAT deductions. As a result a sensitivity table is used to check range of likely shares of total VAT that is final in terms of λ and γ. See Table 1. For example if 50% of VAT is deductible, then some 25% to 35% of the total VAT will become final collections.

Table 1. Final import VAT collections as a share of total VAT collections

		Import VAT as share of VAT collections, λ		
		0.5	0.6	0.7
Share of import VAT deducted, γ	0.3	**0.35**	**0.42**	**0.49**
	0.5	**0.25**	**0.3**	**0.35**
	0.7	**0.15**	**0.18**	**0.21**

In practice, to estimate the share of import VAT that is deductible, γ, in (4), (5) and (8) above, two approaches can be used.[104] One approach is to make estimates directly from the VAT returns in cases where a country requires reporting of whether an input VAT deduction is based on import or domestic VAT paid. The share of import VAT that becomes deductible is found from the import VAT (R_{imp}) and the input VAT deduction from imports R_{dom}^{input} on the domestic VAT return as $\gamma = R_{imp}^{input} / R_{imp}$. Many countries do not require explicit reporting of input VAT deduction claims based on import VAT, but some such as Ghana and Malawi do require such reporting on VAT returns. Even in those countries, however, the import

[103] Graham Glenday, "VAT analysis and revenue estimation based on micro-simulation data," a report prepared for the Ministry of Finance, Ghana, August 2003.
[104] If full computerization of import and VAT data is implemented, then matching of import entries by registered VAT businesses would be possible. The import VAT collections on such entries would give an estimate of the import VAT deductions.

VAT amounts claimed are not reported publicly and special analysis of the VAT returns is required to estimate the amounts.

Another approach is to use the end use categorization of imports, such as provided by the Broad Economic Code (BEC) classification system. If import data includes information about the type of goods and their final use classifications, and the type of importer, then more or less strong inferences can be drawn about whether the import VAT will be deductible or not, and where it is not deductible, whether it is going into final consumption or an exempt business. The type of goods can be broadly classified as capital and transport equipment, industrial inputs, primary goods for industry or consumptions, fuels, consumption goods, etc. These can be used to assign probabilities of their destinations and deductibility. For example, most industrial machinery and capital equipment, and raw and intermediate inputs would have probabilities near 100% of being deductible. If farmers are VAT exempt, then agricultural inputs would be largely non-deductible. In addition, information about the type of importer (VAT registered or not and sector) can be used to identify certain exempt businesses. For example, imports of financial institutions would be exempt business inputs. If the direct data from VAT returns is available to estimate R_{dom}^{input}, consistency checks can be made of the estimates of the probabilities of deductibility of import VAT categories leading to the same aggregate estimate of import VAT deductibility. Unfortunately, few countries report imports classified by end-use and none report import VAT classified by end-use categories. This type of exercise requires special analysis of import data.

APPENDIX D
VAT design and operation in the context of multiple jurisdictions

The VAT is most commonly used as a national tax administered by a central government. As such, the VAT is implemented in most countries across the world as a tax on consumption using the credit-method and destination principle. Goods and services destined for use in a country are taxed – imports are taxed, but exports are not, rather they are zero rated. The credit-method, under ideal circumstances, ensures that all the taxes paid at intermediate stages of production are credited back such that only final consumption is taxed, and exports bear no tax. This VAT structure works well at the country level because of the control of border transactions by a national customs service – imports are taxed and exports can be verified and zero rated. Where VAT is collected as a national tax, VAT revenues typically enter the consolidated revenues and the benefits are distributed to the regions of the country either as transfers or direct expenditures on services delivered in or to the regions of the country. Less commonly, some share of the VAT revenues may be earmarked by some formula for transfer to the regions.[105] In general, under a national VAT there is separation of the collection and regional incidence of the VAT burden (or the regional distribution of taxable final consumption) from the mechanisms for allocating the benefits of the VAT revenues across regions of a country.

This model of the national consumption VAT supported by customs-enforced border controls breaks down in two types of situation. The first case is where a country has a federal structure or any degree of decentralization where the responsibility for VAT collection is allocated to sub-national jurisdictions. A core problem arises because of the lack of border controls between the regions (the states or provinces of the country.) This makes the charging and allocation of the credit-method VAT on a destination basis difficult. The states or provinces are the destinations (or location of consumption) in this case rather than the nation.

The second case arises where countries form customs unions or common markets and weaken or completely remove the border controls on the flows of goods and services between the countries. This is the situation is arising within the SACU, and is also expected to arise within SADC as it forms a common market. It has already arisen within the European Union where fiscal border controls have been removed. No fully satisfactory solution has yet been developed and implemented to deal with this situation. A range of potential solutions has been developed and some have been implemented, but in general the solution has to be designed to fit the institutional circumstances of the different groups of economies. Therefore, an analytical framework is needed to consider what may work in the context of SADC Member States.

This appendix lays out the mechanics of how different VAT structures work (or may work) on international or inter jurisdictional trade. The VAT structures will all retain the basic credit method structure, but consider the use of both destination and origin

[105] For example, China transfers 25% of the domestic component of VAT collected in a province to the provincial government. See Chapter 4 of World Bank, "China National Development and Sub-National Finance: A review of Provincial Expenditures," Report No. 22951-CHA, April 9, 2002.

principles, and within these structures consider situations where border controls are retained or not. Border controls are critical as to whether VAT can be charged and collected on imports or not. A further key consideration for each tax structure is whether the importer is a registered VAT trader or not. This is important in the SADC region given the prevalence of unregistered small and informal sector businesses in most of this region. In each of the tax structures, the total tax burden on final sales need to be examined and the distribution of the revenues between the member countries.

In all the following, the focus is on international trade between member countries of a mature customs union or common market which forms a **single customs territory**. Trades within such a customs union or common market for customs purposes are not treated as "imports" or "exports." Hence, such "**internal trade**" is similar to trade between the states of a federal state. In the case of the destination principle, "**external trade**" with countries outside of customs union or common market are treated in the standard fashion: VAT on imports, zero rate exports. This means that, viewed as a whole, the tax fall on consumption within the customs union or common market. How the internal trade between member countries is treated, however, will effect which internal trades are taxed and at what rates, especially where countries have different tax rates, and which countries actual receive the revenues. In the case of the origin principle, a distinction will be made between whether the origin principle applies to both internal and external trade (such that the VAT falls on production within the customs union or common market), or whether the origin principle applies only to internal trade such that the destination principle on external trade leaves VAT as a tax on consumption within the group of countries, but the revenue distribution is biased towards the countries with the larger shares of production.

Trade across internal borders will be analyzed by focusing on the tax structures affecting the firms or individuals acting as the "exporter" (firm 1) and "importer" (firm 2) and the tax flows accruing to the two jurisdictions or countries. The following range of VAT structures and trades will be analyzed:

I. Destination principle
   a. Border controls and VAT registered/unregistered importers
      i. Zero rated exports
      ii. Deferred VAT
      iii. VAT on internal exports with reconciliation
      iv. Compensating VAT on internal exports
   b. No border controls and VAT registered/unregistered importers
      Same four cases

II. Origin principle
   a. Origin principle on internal and external trade: production base
   b. Origin principal on internal trade, destination principle on external trade
      i. No reconciliation
      ii. Pooling and sharing

I. I. Destination principle

a. Border controls

i. Zero-rated exports

Zero-rated exports is the normal arrangement for a destination-based national VAT. In this case, internal exports are zero rated such that $t_o = 0$. See Fig D1. If the importer is registered for VAT, VAT is collected on the internal imports at t_i which is then credited to the registered importer, firm 2, $t_{ic} = t_i$, and firm 2, then collects the VAT on final sales of t_f. From these transactions, the total tax collected is $t_{f.}$ The revenues collected by countries A and B, R_A and R_B are given by:

$R_A = t_o = 0$

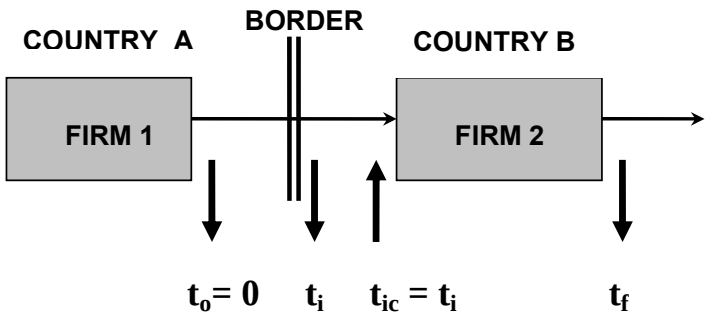
$R_B = t_i - t_{ic} + t_{f.} = t_{f.}$

If the importer is unregistered, then the import VAT, t_i is the final VAT (and country B forgoes ($t_{f.} - t_i$), and the revenue collections are:

$R_A = t_o = 0$

$R_B = t_{i.}$

Fig D1. Normal zero rating



ii. Deferred VAT

Here the situation is the same as with normal zero-rated exports, except that **the importing country allows the registered firm to defer paying the import VAT until it claims the input VAT credit such that no VAT is actually collected at the point of import and no credit is paid to the importing firm.** The final VAT is collected on the sales of the registered importer. See Figure D2. As an example, this deferment arrangement is provided for specified capital equipment imports in Zambia. It avoids any cash flows costs to the importing firm that arise from the delay in receiving a refund for the import VAT on the investment. Deferment, however, forgoes the discipline on the registered importer of having to claim the import VAT out of output VAT collections. Effective control of deferment therefore requires the cross checking of import entries against

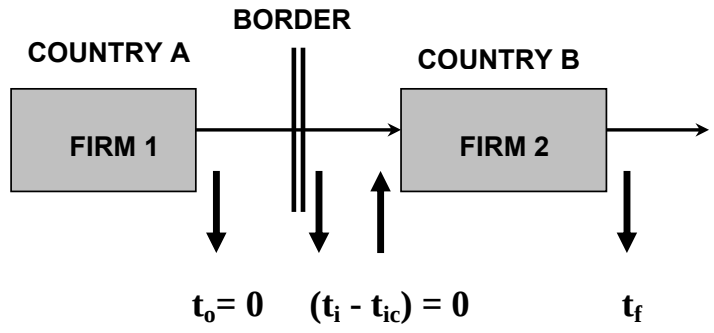
domestic VAT returns. The revenues collected by the countries are given by:

$R_A = t_o = 0$
$R_B = (t_i - t_{ic}) + t_{f.} = t_{f.}$

If the importer is unregistered, no deferment of the import VAT is offered and the import VAT, t_i is the final VAT, and the revenue collections are:

$R_A = t_o = 0$
$R_B = t_{i.}$

Fig D2. Deferment



iii. VAT on internal exports with reconciliation

Under this arrangement, **internal exports are not zero rated**, but the importing country gives credit based on VAT invoices at the point of importation for the VAT paid in the exporting country, t_o, against the gross import VAT payable, t_i. If the importer is a registered company, it claims

⟹

an input VAT credit for the gross import VAT payable ($t_{ic} = t_i$) against the final output VAT collected, t_f. **The importing country claims compensation for the VAT collected in the exporting country, $c_o = t_o$, based on import documents**. **With two-way internal trade, periodic reconciliation of the mutual debts on export VAT can be settled**. See Figure D3. This mechanism requires an **international treaty** between the countries and a **super-national agency** to supervise the net compensation payments. This type of mechanism provides defense against export frauds caused by export zero rating which can encourage either false claims of exports or rounding tripping of goods (exportation followed by re-importation without declaration.) Both export frauds cause the exporting country to lose VAT revenues on what are actually domestic sales. This problem arises where there are weak border controls and considerable cross-border shopping such as is the case between South Africa and Lesotho. An early version of this type of structure was referred to as a

"bilateral transfer" mechanism.[106] Over recent years a draft tax treaty between South Africa and Lesotho has been arranged to facilitate such a mechanism.[107] This mechanism of taxing internal exports with compensation to the importing country has been successfully implemented between South Africa and Lesotho since 2003 after the establishment of the Lesotho Revenue Authority.

In the case of registered firms importing, the revenue collections by countries A and B are:

$R_A = t_o - c_o = 0$

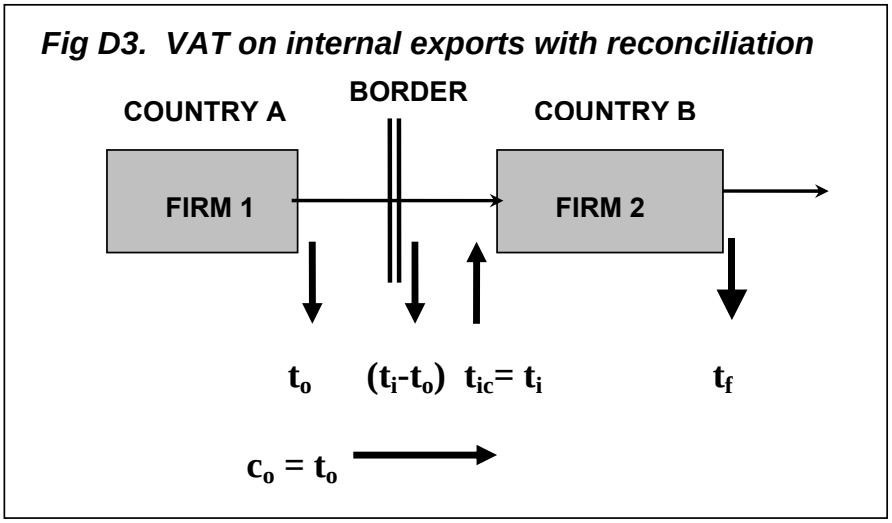
$R_B = (t_i - t_o) - t_{ic} + c_o + t_{f.} = t_{f.}$

If the importer is unregistered, then the import VAT, t_i is the final VAT, and the revenue collections are:

$R_A = t_o - c_o = 0$

$R_B = (t_i - t_o) + c_o = t_{i.}$

Fig D3. VAT on internal exports with reconciliation



iv. Compensating VAT on internal exports

Here, instead of charging the normal VAT rate of country A on the internal export (as in the case iii. above), **a special or compensating VAT rate, c_o, is charged on internal exports**. This structure has been referred to as a CVAT.[108] As above, country B gives credit for the VAT paid in country

[106] Graham Glenday, "The Design of Bilateral Direct Transfer Schemes between Lesotho and the Republic of South Africa," International Tax Program, Harvard Law Scholl, Development Discussion Paper No 487, April 1994.

[107] *Agreement between the Government of the Republic of South Africa and the Government of the Kingdom of Lesotho on Mutual Assistance and Co-operation and the Prevention of Fiscal Evasion with respect to Sales Tax and Value-Added Tax*, Draft 2002

[108] Ricardo Versano, "Subnational Taxation and the Treatment of Interstate Trade in Brazil: Problems and a Proposed Solution," in S. J. Burki and G. Peary, Eds, *Decentralization and Accountability in the Public Sector*, Proceedings of the Annual Bank Conference on Development in Latin America and the Caribbean, Washington, World Bank (1999); Charles E. McLure, "Implementing Sub-National Value Added Taxes on Internal Trade: The Compensating VAT (CVAT), *International Tax and Public*

A on the import, and then, if the importer is VAT registered, credit is paid for the gross import VAT payable in country B, and a output VAT is paid on the supplies by the registered importer. Country B should charge the same compensating VAT rate on internal imports. Country A compensates country B for c_o, the VAT collected on the internal export. See Figure D4. This structure is essentially the same as the internal VAT on exports above, the compensating VAT rate is a rate agreed by both countries to be charged on internal trade. In that case, $t_i = c_o$ and $(t_i - c_o) = 0$ and $t_{ic} = t_i = c_o$. The compensating tax rate may differ from standard VAT rates of both the countries. One institutional difference that can be introduced is that the compensating VAT is paid directly to the super-national agency that reconciles the trade accounts and makes *gross* payments to the importing countries. This results in different timing of tax flows compared to the case of countries collecting the internal export VAT and making reconciliation balance payments to the net importing member countries, as elaborated on further below.

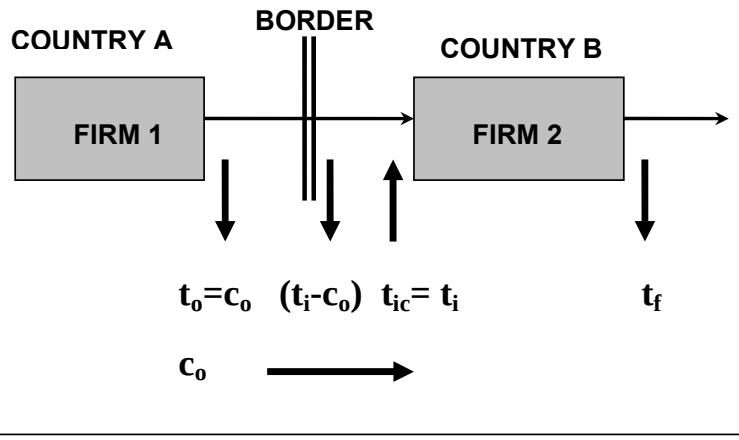
In the special case, where both countries have the same uniform standard VAT rate, $t_o = t_i = c_o$, and both VAT charging of VAT on internal exports and the charging of compensating VAT on internal exports gives the same results.

Another special case is if $c_o = 0$, then the result is the same as case (ii) above of zero rated exports and deferment of import credits – no VAT is collected on the internal trade and no compensation is paid. An important difference arises with unregistered importers, however, as they would pay no import VAT if $t_i = c_o = 0$, whereas unregistered importers would not qualify for deferment and would pay the import VAT.

The advantage of the CVAT over the general case of charging VAT on internal exports discussed above arises from the both export VAT and import VAT being charged at the same rate. The border rate is known by both sides with certainty and no tax differential $(t_i - t_o)$ arises on internal imports. The disadvantage is that it puts an obligation on the exporting business to differentiate between domestic sales at t_o and internal exports at c_o as well as external exports at zero.

Finance, 7(6), pp 723-40, (2000); Michael Keen, "CVAT, VIVAT and All That: New Forms of VAT for Federal Systems," *Canadian Tax Journal*, 48(2), pp 409-24 (2000).

Fig D4. Compensating VAT on internal exports with reconciliation



A more general case of the CVAT has been proposed where the special VAT rate would be charged on all trades between all registered firms located within the member countries. This has been called the VIVAT or the Viable Integrated VAT.[109] The actual required VAT would be charged on all final VAT sales to individuals and unregistered businesses. The VIVAT becomes the same as the CVAT in its treatment of internal trade if the special VAT rate is extended to all internal exports such that unregistered importers pay the special VAT rate in addition to the registered importers.

One important summary conclusion is that with border controls, the non-registered importer pays VAT directly to country B as import VAT if the internal exports are zero rated, and indirectly through the reconciliation payments if VAT is charged on the internal exports. Country B collects the import VAT in all cases with border controls.

The cases where border controls do not exist are now covered. Note that **distance shopping by importers (internal imports initiated by telecommunications or mail) is effectively the same as internal trade without border controls unless all postal and shipping agents are under customs controls.** Similarly, **the taxation of imported services is also effectively the same as internal trade without border controls.**

[109] Michael Keen and Stephen Smith, "The Future of the Value added Tax in the European Union," *Economic Policy*, Oct (23), pp375-411, 419-20 (1996); Michael Keen and Stephen Smith, "Viva VIVAT!", *International Tax and Public Finance*, 7(6), pp 741-51, (2000)

I. Destination principle

b. No border controls

i. Zero rated exports

Without internal border controls, country A has no way of confirming exports to country B without the co-operation of country B such that fraudulent export claims by firms in A are likely. Country B, however, can only effectively assist country A confirm exports if the importer is a registered business. In the case of unregistered businesses or individuals in country B importing from country A, country B has difficulty in enforcing the collection of import VAT such that no VAT is collected, $t_i = 0$. In the case of registered firms, import VAT cannot be collected at the border, but can be self-declared by the firm at the time of filing a domestic VAT return (or VAT is collected by reverse charging by the importer) in which case a credit is simultaneously claimed, and hence, only the output tax paid. Note that **self-declaration of the import VAT is effectively the same as the deferred VAT structure** above such that $(t_i - t_{ic}) = 0$. This is effectively the same as setting the import VAT at zero on internal imports ($t_i = 0$ and $t_{ic} = t_i = 0$).

In the case of registered firms importing, the revenue collections by countries A and B are:

$R_A = t_o = 0$
$R_B = (t_i - t_{ic}) + t_{f.} = t_{f.}$

If the importer is unregistered, then the import VAT, t_i is the final VAT, and the revenue collections are:

$R_A = t_o = 0$
$R_B = t_i = 0$

The EU under its current "transitional arrangements" effectively administers a borderless destination-based system with zero rated internal exports. As just noted above, such a system works effectively for goods exports and where the import is VAT registered. In addition, a significant level of administrative co-operation should be possible to confirm exports from information from importing businesses. This system breaks down if importers of goods are unregistered businesses or individuals. This is common with distance shopping and service purchases by unregistered importers. In the case of services, other than consulting and financial services, which are subject to reverse charging on importation, origin-based VAT is charged and the registered importer is expected to claim a refund from its own revenue authority rather than being compensated by the exporting authority.

ii. Deferred VAT

As discussed above, without border controls, imports by registered firms effectively get deferred import VAT treatment if import VAT is charged, given that the import VAT would be paid at the same time as the input VAT is claimed. Deferred VAT effectively has no relevance to

unregistered importers. The result is that tax burdens and tax collections are the same as the case of normal zero rating without border controls above. Neither country collects VAT on internal imports by unregistered traders

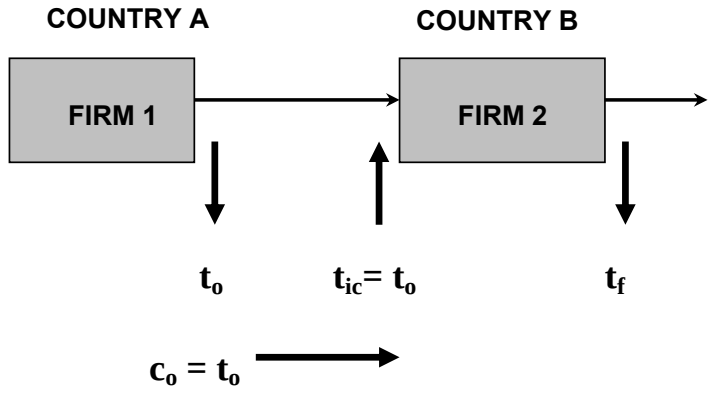
iii. VAT on internal exports with reconciliation

If VAT is charged on internal exports from country A to B, then, in the case of a registered importer, country B awards the importing firm a VAT credit for the VAT collected by country A against the output VAT of the firm, t_f. See Figure D5. **Country B then claims compensation from country A based on the input VAT claim of firm 2 and the VAT invoice issued by firm 1.** Given internal trade is going both ways between countries A and B, only the net amount of VAT claimed is paid by the country with a positive trade balance in taxable goods and service to the country with the negative trade balance. This VAT reconciliation process would require an international tax treaty between the countries and a supervisory agency to ensure its implementation.

There are strong conflicts of interest here that the treaty will need to resolve. Country A will only want to pay compensation for actual tax collections on internal exports. Country B will only want to credit input VAT up to the amount it will receive as compensation, but firm 2 will want to claim all the VAT it pays on the inputs. If Country A under collects, then it would need to bear the risk of compensating country B for the VAT paid by firm 2 and claimed as a credit. Country A will have an interest in ensuring firm 2 does not over claim. The supervisory agency will have to have the powers to reconcile the sales of firm 1 with the purchases of firm 2.

If the importer is an unregistered person, then the process of country B claiming the VAT on the consumption by its person is not feasible. Country A collects the VAT revenue and the tax rate paid by the importer would depend on the VAT rate in country A which may be higher or lower than that in B.

Fig D5. VAT on internal exports with reconciliation

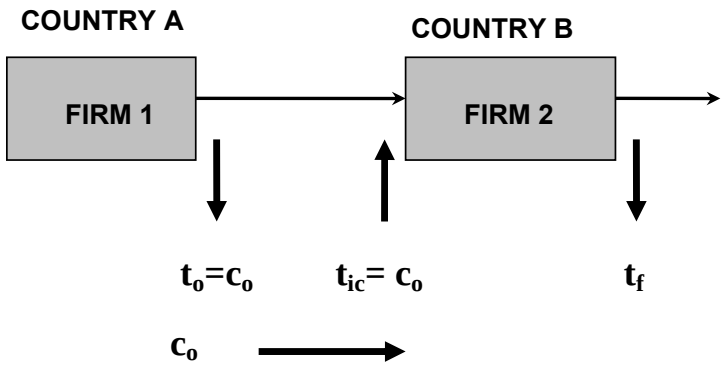


of the exporting country being charged on exports, as discusses above, with the following differences. See Figure D6. First, the compensating VAT rate may be the same or different from that of the exporting country.

Second, the compensating tax could be paid to a separate supervisory agency for reconciliation and payment of the gross compensation amounts to the importing countries. Alternatively, a system of net reconciliation payments could be maintained as discussed above, but then the exporting countries collect the compensating VAT and the supervisory agency determines the net reconciliation payments to be made by the net exporting country. As discussed above, the supervisory agency would need information on to confirm exports and imports to calculate and/or confirm reconciliation payments.

Third, if the importer is unregistered, in the case of the compensating tax being paid to a supervisory agency, then the importing country may or may not capture the tax. The exporting firm in country A would pay the tax to this agency if it had information that the buyer was a resident of country B (as would be the case of a mail order or other direct shipment). The agency would then compensate country B. If the exporting firm, was unaware of the location of the buyer it would charge the domestic VAT rate by default and country A would collect the VAT on the export.

Fig D6. Compensating VAT on internal exports with reconciliation



In the case of registered firms importing, the revenue collections by countries A and B are:

$R_A = c_o - c_o = 0$

$R_B = - c_o + c_o + t_{f.} = t_{f.}$

If the importer is unregistered, then the domestic VAT, t_o is the final VAT if the location of the buyer was unknown, but the compensating tax is charged if the importer is identified as being from country B, and the revenue collections are:

$R_A = t_o$ or $c_o - c_o = 0$

$R_B = 0$ or c_o

In summary, a destination VAT can operate such that the target is the consumption within the borders of member countries so long as there are international treaties to reconcile the VAT charged on internal exports. **Problems remain with the proper allocation of VAT to the consuming countries with internal exports made to unregistered persons**. **In the case of a compensating VAT paid to a supervisory agency, a higher share of the VAT can be paid to the importing country where the residency of the buyer can be determined, as with direct order and shipments; otherwise the country of origin will capture the VAT.**

II. Origin principle

a. Origin principle on internal and external trade: production base

Under the origin principle, VAT is charged on exports, but not on imports. Without any adjustments, this results in tax being charged and collected on a production rather than consumption base. A production tax will be expected to reduce exports, which in turn will weaken the real exchange rate and result in offsetting increases in exports and decreases in imports. By contrast, a consumption tax reduces imports and strengthens the real exchange resulting in increases in imports and decreases in exports. With these offsetting exchange rate effects, if real trade is balanced, then the two tax bases are similar. If a country has major trade deficit, however, consumption may be a larger effective base than production.

Under the origin principle, exports are taxed. Under the credit-method, this export VAT should be credited against any subsequent VAT to prevent tax stacking prior to the final sale. The importing country, however, will have difficulty in verifying the VAT paid on the imported inputs without special arrangements. As a result, the import country has to resort to crediting the registered firm with a notional input VAT, possibly equal to the standard VAT that would have been paid on the import, t_{ic}= "t_i". See Figure D7. The firm then credits this "input tax" against its output VAT. With an international treaty, the exporter could supply copies of tax-paid invoices to the importing firm 2 and country B could have the right to request confirmation of the VAT paid from country A and then give a credit for this VAT, or $t_{ic} = t_o$ exactly. This crediting process by the importing country does not depend upon border controls. The importing country then collects VAT from the stages of

production within its borders. If the importer is unregistered, no further VAT is collected in the importing country (country B) as if this is final consumption.

If the importer is registered, the revenues collected by countries A and B are given by:

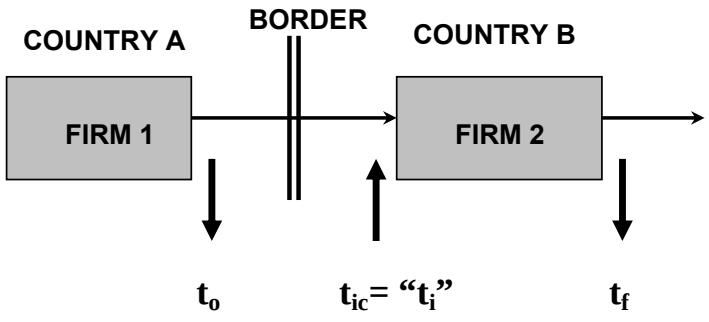
$R_A = t_o$
$R_B = - t_{ic} + t_f$.
$R_A + R_B = t_o - t_{ic} + t_f$
$= t_f$, if $t_{ic} = t_o$

If the importer is unregistered, then the revenue collections are:

$R_A = t_o$
$R_B = 0$.

An origin tax can effectively be collected from all registered traders on all supplies (including services and distance sales to persons in other countries) at the point of sale rather than at the point of export. Exports by unregistered traders would be missed without border collection of the export VAT, but this is usually less of a problem in that exporters are typically the larger businesses in an economy. If border controls exist, then payment of VAT on goods exports can be enforced by customs, but not on exported services. Generally, in the case of origin-based taxes, border control does not serve such a key role in ensuring the correct collection of taxes as does border control in the case of a destination based tax.

Fig D7. VAT on exports: origin principle



b. Origin principal on internal trade, destination principle on external trade

i. No reconciliation

As pointed out above, taxing consumption is generally viewed as the more attractive VAT base than production, but the origin principle operates better in an environment of weak or no border controls. This leads to consideration of a structure of applying the destination principle to

external trade of the member countries of a customs union or common market, but applying the origin principle to internal trade where there may be weak or no border controls. If the origin principle is limited to internal trade among member countries, then exports to third party countries receive normal zero rating under the destination principle and imports from third party countries are subject to import VAT. This results in the VAT falling on consumption within the customs union or common market, but the **VAT revenues collected may *not* be distributed among the countries according to consumption** within the countries if the origin principal is applied for internal trade as the VAT charged on internal exports is retained in the exporting country **unless some compensatory payments are made between the countries**. Note that this is essentially what happens in the destination cases above without border controls either where VAT is charged on internal exports or where a special compensating VAT is charged on internal exports in the presence of a supervisory agent. In both these cases, however, the import country is compensated for the VAT on internal exports and the importing firm receives a VAT credit equal to this tax charged on the internal exports such that the importing country collects the full amount of the tax. With origin taxation in the presence of some tax treaty to help ensure that $t_{ic} = t_{o,}$ the tax collections by the countries would be as follows:

If the importer is registered, the revenues collected by countries A and B are given by:

$R_A = t_o$

$R_B = - t_{ic} + t_{f.}$

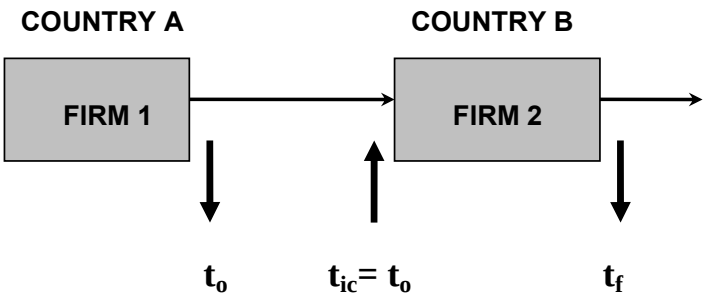
$R_A + R_B = t_f$

If the importer is unregistered, then the revenue collections are:

$R_A = t_o$

$R_B = 0_.$

Fig D8. VAT on internal exports: origin principle and international supervision



Origin taxation of the internal trade leaves the imports into country B subject to the same total taxation as in the case of taxation of internal exports under the destination principle without border controls, but the distribution of the revenues will favor the countries with a higher share of the taxable production (net internal exports) rather than taxable consumption (net internal imports).[110] Note that tax will be collected at least at the tax rate of the exporting country on all taxable supplies, no mater whether they are supplied to a registered or unregistered persons or are services or distance sales.

The same tax coverage can be achieved by use of the compensating VAT on all internal exports of goods or services and distance sales where the location of the buyer is unknown. Compensation of the importing country is required, however, where input credits are awarded for the import VAT, and where the compensating tax is allocated to the importing country in the cases of final sales of goods or services to unregistered importers. This results in the countries with the higher share of consumption (or net internal imports) receiving the higher share of the revenues from internal trade. It is also consistent with the destination approach being applied to external trade that results in a consumption base for the VAT.

ii. Pooling and sharing

Another approach for the revenues to better match consumption rather than production bases, using the origin principal for internal trade, but destination principle for external trade, is to pool all the VAT collections from all the member countries and then allocate shares in the pool in proportion to estimates of the GDP or consumption or more accurate estimates of the value of the VAT base of each member country. **This requires a common tax structure be applied across all countries**. This approach has been suggested for the European Union[111] and will be applied under the new SACU Agreement for the collection of excise duties.

In summary, three choices of credit-method VAT emerge for SADC that would allow a weakening of internal border controls as common market is developed.

1. Destination principle supported by a **special uniform compensating VAT paid to a super national agency on all internal exports of goods and services and all distance sales outside of the country**. A VAT treaty would be required to provide for enforcement co-operation and reconciliation of VAT compensation payments. Countries could have different VAT rates. Revenues would be close to those from a national consumption tax base. If border controls are weakened and agreement

[110] With origin taxation internally and destination taxation externally, unusual distributions of VAT could arise depending upon the trade balances of countries internally and externally. A country that is a net external importer, but a net internal exporter would gain a disproportionately high share of the total revenues of all member countries. By contrast, a country that was a net external exporter, but net internal importer would receive a disproportionately low share of the total revenues.

[111] Commission of the European Communities, "A Common System of VAT: A Programme for the Single Market," COM(96) 328, July 1996.

cannot be reached on a uniform compensating tax rate, then, **at a minimum, VAT should be charged on internal exports.**

2. **Destination principle applied to external trade, but the origin principle applied to internal trade** supported by an international treaty to allow cross-border checking, enforcement and dispute resolution. Countries could have different VAT rates. While aggregate common market VAT revenues would be derived out of a consumption base, revenues would go disproportionately more to countries that were net internal exporters.

3. VAT collections put in a common pool from collections on a destination basis from external trade and origin basis from internal trade. All countries would have to apply the same VAT structure. Revenues are collected in a common pool and shared in proportion to a measure of consumption. Two partial pooling and sharing formulas, however, are presented in Appendix E to deal with some of the adverse incentives and measurement difficulties that arise with complete pooling.

Appendix E
Revenue Sharing Formulas

One approach to implementing a multi-jurisdictional VAT is "pooling and sharing." This approach requires that (i) a uniform VAT structure is applied across all jurisdictions, (ii) VAT is charged on internal trade using the origin principle (as if all jurisdictions were part of a unified country), (iii) all revenues are pooled, and then (iv) the pool is shared according to estimated shares by each jurisdiction of total consumption. While conceptually simple, a few major concerns arise in practice. Aside from the issues of accurately estimating the consumption base in each jurisdiction for purposes of revenue sharing, concerns arise about:

i. the weak incentive of each jurisdiction to make an effort to collect VAT, especially if a jurisdiction will get a share of the revenue pool irrespective of its effort – a basic "free rider" problem, and

ii. the different efficiencies of the VAT systems across jurisdictions that arise from differences in the bases that are not measurable[112], differential compliance as well as differential tax administration effectiveness. The jurisdictions with low VAT efficiency will tend to get a higher share of the revenues than their tax effort and efficiency would justify.

Two related approaches to mitigating these problems are explored here. The one is **partial retention by each jurisdiction combined with consumption-based revenue sharing of the residual pool,** and the other is almost full **retention combined with adjustments for internal trade imbalances**. In both cases, the higher the degree of retention of VAT collected within a state, the less the adverse incentive and differential efficiency concerns.

E.1. Partial Retention Combined With Consumption-Based Revenue Sharing

Here "n" different jurisdictions in a common market or federation all apply the same VAT structure. Jurisdiction "i" would collect R_i^C if it applied a consumption-based VAT on a destination principle with VAT efficiency e_i on a consumption base C_i, which is a share c_i of the total consumption base C^T across all jurisdictions. Alternatively, it would collect R_i^O if it applied the origin principle on internal trade and pooled all the revenues. Net internal exporters would collect more under the origin principle than the destination principal, and the reverse for net internal importers. The total revenues from all jurisdictions, R^T, would be given by [113]

[112] The effects on the VAT base of some VAT exemptions, such as that for small businesses, are not readily measurable, as the exemption categories may not match standard statistical categories.

[113] Here the effects of differences in tax efficiency between jurisdictions on internal trade are ignored. The switch from destination to origin-based collection results in the exporting state collecting rather than the importing state. If the importing state was the more efficient VAT collector than the exporting state, then total revenues may fall, and vice versa.

$$R^T = \sum_i^n R_i^C = \sum_i^n R_i^O \qquad \text{E.1}$$

and the share of total VAT revenues collected by jurisdiction "i", α_i, would be given by the **efficiency weighted** share of consumption[114]

$$\alpha_i = \frac{e_i C_i}{\sum e_i C_i} = \frac{e_i c_i}{\sum e_i c_i} = \frac{R_i^C}{R^T} \qquad \text{E.2}$$

In the case of all jurisdictions having the same VAT efficiency, then the share of total VAT revenue owed to a jurisdiction would be its share of total consumption, c_i. If the share of total consumption is used to share this revenue pool rather than the efficiency weighted share, then jurisdictions with below average efficiency will get higher revenue shares. Unfortunately, measures of VAT efficiency, e_i, are generally not available.

Now, if the origin principle is applied to all internal trade such that the collection in the jurisdiction is R_i^O, and if each jurisdiction can withhold a share ρ_i of R_i^O with the remainder going into the pool, then (i) the retained amount in the jurisdiction R_i^R would be given by

$$R_i^R = \rho_i R_i^O \qquad \text{E.3}$$

and (ii) the pool of revenues from all "n" jurisdictions, R^P, would be given by

$$R^P = \sum_i^n (1-\rho_i) R_i^O = R^T - \sum_i^n \rho_i R_i^O \qquad \text{E.4}$$

and (iii) the revenue share received by the jurisdiction from the pool, R_i^P, would be given by

$$R_i^P = c_i R^P \qquad \text{E.5}$$

Hence, the total revenue of the jurisdiction from retentions and its share of the pool would be given by

$$R_i = \rho_i R_i^O + c_i R^P \qquad \text{E.6}$$

Now, the combined retentions and pool share of the jurisdiction should equal the expected consumption based revenues R_i^C, which from E.2 and E.6 is given by:

$$R_i^C = \alpha_i R^T = \rho_i R_i^O + c_i R^P \qquad \text{E.7}$$

[114] If there are different positive VAT rates, then the effective bases would also need to be weighted by the different positive tax rates. Here it is assumed that only one positive VAT rate is used.

Hence, the retention rate for the jurisdiction, using E.4, should be set at

$$\begin{aligned} \rho_i &= \frac{R_i^C - c_i R^P}{R_i^O} \\ &= \frac{\alpha_i R^T - c_i R^P}{R_i^O} \\ &= \frac{(\alpha_i - c_i) R^T - c_i \sum_j^N \rho_j R_j^O}{R_i^O} \end{aligned} \qquad \text{E.8}$$

If all jurisdictions have the same VAT efficiency, then $\alpha_i = c_i$ and the retention rate, ρ_i, should be set at zero and all collections go into the pool for sharing in terms of consumption shares, c_i. Otherwise to have each jurisdiction receive R_i^C as per E.7, retention rates vary across jurisdictions and are higher in jurisdictions with relatively higher VAT efficiency such that $\alpha_i > c_i$, but lower the higher R_i^O owing to net internal exports. Retention rates could be negative for very inefficient jurisdictions. Is it possible that retention rates would be equal across jurisdictions? The conditions for this can be checked by setting all $\rho_j = \rho_i$ in E.8 and solving for ρ_i as follows:

$$\rho_i = \frac{\alpha_i - c_i}{R_i^O / R^T - c_i} \qquad \text{E.9}$$

Inspection of E.9 shows that an equal retention rate is possible if the more VAT efficient jurisdictions ($\alpha_i > c_i$) are also net internal exporters ($R_i^O > R_i^C$ such that $R_i^O / R^T > c_i$) and all the more VAT inefficient ones ($\alpha_i < c_i$) are net internal importers ($R_i^O < R_i^C$ such that $R_i^O / R^T < c_i$). This condition may be approximated within SADC, but is not necessarily generally the case. Using some level of retention, however, say 50% across all jurisdictions, can be expected to improve the allocation and collection efficiency compared to no retention at all. An exception arises when the most VAT efficient countries are net internal importers – not a likely situation. In this case, such countries should receive a disproportionately large share of the largest possible pool.

E.2. Retention combined with Adjustments for Internal Trade Imbalances

An alternative approach to revenue sharing is to focus on the trade imbalances in the internal trade between members of a common market or federation. Under a consumption-based VAT, internal exports are zero-rated and internal imports are taxed, but the reverse is the case if internal trade is subject to origin-based VAT. Hence, if the for jurisdiction "i" the internal exports are IX_i, internal imports are

IM_i, the net internal exports are $NX_i = (IX_i - IM_i)$, and as a share of revenues are $x_i = NX_i\, t / R_i^O$ and where t is the effective VAT rate, then the revenues from origin and consumption-based revenues is given by

$$\begin{aligned} R_i^C &= R_i^O - (IX_i - IM_i)t \\ &= R_i^O - NX_i\, t \\ &= R_i^O(1 - x_i) \end{aligned} \qquad \text{E.10}$$

When VAT on internal trade is taxed on an origin basis, but jurisdictions are owed the tax that would be collected on a consumption base, jurisdictions that are net importers need to be compensated by jurisdiction that are net exporters. To achieve this, the net exporters need to contribute to a pool to compensate the net importers. Hence, net importers can be allowed to retain all collections, whereas net exporters need to contribute to the compensation pool. This structure effectively internalizes the VAT collection incentives and efficiencies within jurisdictions.

Following this approach, if jurisdiction "i" is a net internal importer or $x_i \le 0$, then $\rho_i = 1$ and the jurisdiction retains all its collections and looks to the pool for compensation for VAT charged by other jurisdictions on its internal imports. By contrast, if jurisdiction "j" is a net internal exporter or $x_j > 0$, then $\rho_j = 1 - x_j$ and the final revenues of the jurisdiction, R_j, are its retained revenue:

$$R_j = \rho_j R_j^O = (1 - x_j) R_j^O \qquad \text{E.11}$$

The pool revenues from the revenues not retained by the "m" net internal exporting jurisdictions amounts to:

$$\boldsymbol{R^P} = \sum_j^m \boldsymbol{x_j R_j^O} \qquad \text{E.12}$$

This revenue pool should divided among the (n-m) net internal importing jurisdictions in proportion to their net internal export revenues forgone by the origin-based VAT on internal trade such that for jurisdiction "k":

$$\boldsymbol{R_k^P} = \frac{\boldsymbol{x_i R_i^O}}{\sum_i^{n-m} \boldsymbol{x_i R_i^O}} \boldsymbol{R^P} \qquad \text{E.13}$$

Hence, the net internal importing jurisdiction revenues from retentions and its pool share amount to

$$R_k = R_k^O + R_k^P \qquad \text{E.14}$$

While this approach of full retention by net internal importers and compensation from the net exporters forms a relatively simple structure and clear retention and pooling

obligations, it does require member jurisdictions to maintain records of internal trade to measure the net internal trade balance of each country. This means that national customs services would need to maintain control over and record internal trade and in a fashion similar that which exists within the Southern African Customs Union to share customs duties.

Problem of retentions on international trade

It needs to be recognized that one of the advantages of no retentions and the pooling and sharing of all VAT collections avoids the problem of collecting VAT on international imports which may be assigned either to the country in which the imports arrive, or one of the other member countries if they enter in transit. When all or a share of VAT revenues collected in a jurisdiction are retained, retentions on international import VAT need to be assigned to the jurisdiction of destination of the imports. Hence, while the approach of using retentions to deal with the problems of lack of collection incentives and differential efficiency, it does add the administrative problem of assigning the import VAT among member countries where imports are destined to importers outside of the jurisdiction of arrival. Retentions collected on imports destined for another country should be paid to the member country of final destination. In the case of sharing of the net internal export revenue, however, this adjustment for imports arriving on one state where revenue are collected and then exported to another state would be made as part of the internal trade sharing adjustments based on net internal exports and imports.

APPENDIX F
VAT ADMINISTRATION QUESTIONNAIRE

AN ASSESSMENT OF THE CURRENT STATE OF VAT IMPLEMENTATION IN SADC MEMBER STATES

Tax administration capacity questions for Member States:

(Note – please provide answers electronically in the grey shaded area.)

1. Tax Administration

1.1 Organization of VAT/Sales tax administration
1.1.1 Is tax administration the responsibility of a Revenue Authority or a Department of the Ministry of Finance
Answer:
1.1.2 Is VAT/sales tax administration conducted by a separate department or is it integrated with the customs or income tax administration
Answer:
1.1.3 Organization of tax administration across types of tax – how is each type of inland tax[1] is administered? Separately or in an integrated fashion? The latter integrated approach is referred to as functional administration where each function (audit, debt collection, etc) is administered by one unit for all inland taxes. If a functional approach is used, is there a tax administration law for all inland taxes?
Answer:
1.1.4 Is a Large Taxpayer Unit (LPU) used? If yes,
Answer:
1.1.4.1 Which taxes are collected and what are the criteria for taxpayers to be serviced by LTU? What is total number of taxpayers serviced by LTU?
Answer:
1.1.4.2 How many VAT/sales taxpayers are serviced by LTU? What share of VAT revenues collected by LTU?
Answer:
1.1.5 What are the arrangements for the appointment of and reporting by top managers of revenue agencies, including VAT commissioner?
Answer:

1.2 Tax administration expenditures for past three financial years
1.2.1 Total tax administration expenditures (breakdown if available into personnel, capital and other current)
Answer:
1.2.2 Administrative expenditures on Customs

[1] Inland taxes include all taxes collected from domestic persons, but exclude all taxes collected from border transactions (imports or exports)

Answer:
1.2.3 Administrative expenditures on VAT or Sales Tax
Answer:
1.2.4 What are the mechanisms for determining budget of tax agencies? For example, are they based on a legislated formula or are they negotiated each year with the Ministry of Finance?
Answer:

1.3 Registered VAT/sales tax businesses
1.3.1 Number of registered businesses?
Answer:
1.3.2 Number of active VAT/sales taxpayers: businesses paying tax or generating credits/refunds or filing returns in a year?
Answer:
1.3.3 What is distribution of registered businesses by annual turnover?
Answer:
1.3.4 What is minimum turnover rate for compulsory registration?
Answer:

1.4 VAT/sales tax personnel
1.4.1 Number of tax officer positions in establishment? Number filled and vacant?
Answer:
1.4.2 Qualifications of tax officers
Answer:
1.4.2.1 Number of officers with university degrees?
Answer:
1.4.2.2 Number of qualified professional accountants (indicate whether included above or not)?
Answer:
1.4.2.3 Number of officers with other post secondary school certifications? Give examples of types of certificates included.
Answer:
1.4.3 Number of support or administrative staff in establishment? Number filled and vacant?
Answer:

1.5 Pay scales of tax officers
1.5.1 Are pay scales the same or different scales from civil service?
Answer:
1.5.2 Are conditions of employment of tax officers the same or different from the civil service? If different, please elaborate?
Answer:
1.5.3 Comment on the adequacy of salary and benefit packages to retain tax officers?
Answer:

1.6 Degree of computerization of Customs and VAT/sales tax administration
1.6.1 Which of three descriptions below best describes the degree of computerization of Customs?

Answer:
1.6.1.1 Only revenue collection and trade statistics are computerized
Answer:
1.6.1.2 Customs administration data (including revenue collection and trade statistics) are computerized, but a parallel paper process is maintained as final basis for customs clearing and enforcement
Answer:
1.6.1.3 All customs administration processes and data bases are computerized which is also the primary basis for customs clearing and enforcement
Answer:
1.6.2 Which of three descriptions below best describes the degree of computerization of VAT/sales tax?
Answer:
1.6.2.1 Only revenue collection statistics are computerized
Answer:
1.6.2.2 All data from VAT/sales tax forms and accounts are computerized, but parallel paper process is maintained as final basis for administration and enforcement
Answer:
1.6.2.3 All VAT/sales tax administration processes and data bases are computerized which is also the primary basis for administration and enforcement
Answer:

1.7 Audit capacity and procedures
1.7.1 Organization of internal audit capacity? Location and reporting in organization?
Answer:
1.7.2 Desk audit procedures?
Answer:
1.7.3 Organization of field audit capacity?
Answer:
1.7.3.1 Number and qualifications of field auditors
Answer:
1.7.3.2 Describe audit selection process? Use of risk assessment
Answer:
1.7.3.3 Type and frequency of audits?
Answer:
1.7.3.4 Nature of audit reports and follow-up procedures?
Answer:
1.7.3.5 Oversight procedures for field audits?
Answer:

1.8 Arrears/debt collection
1.8.1 Organization of debt collection? Separate unit?
Answer:
1.8.2 Number of tax officers dedicated to debt collection?
Answer:
1.8.3 Debt enforcement mechanisms used (penalties and interest, demand notices,

attachment of accounts, attachment of property, courts, etc)?
Answer:

1.9 Penalties and enforcement processes
1.9.1 Are courts used to prosecute VAT/sales tax fraud cases? If yes, how many cases a year are prosecuted?
Answer:
1.9.2 Number of cases of administrative penalties per year (if possibly by type – inadequate books and records, late/no filing, underpayment, etc)
Answer:

1.10 Taxpayer appeals systems
1.10.1 What levels of appeal are open to taxpayer under VAT/sales tax?
Appeal to Commissioner, Minister, Tribunal, Courts, etc?
Answer:

1.11 Taxpayer service capacity
1.11.1 Mechanisms for educating new taxpayers (visits, courses, booklets, pamphlets, etc)?
Answer:
1.11.2 Mechanisms for educating taxpayers of change in laws, regulations or procedures (radio, TV, newspapers, web site, pamphlets, workshops, etc)
Answer:
1.11.3 Capacities and strategies to service taxpayers (dedicated office, dedicated telephone, web site, workshops for accounting profession, etc)
Answer:

1.12 Training capacities
1.12.1 Training school?
Answer:
1.12.2 Courses offered (entry and refresher courses – type, duration and frequency of courses)?
Answer:
1.12.3 Use of external training facilities in-country and/or outside of country – type and location of courses
Answer:

2. Tax stocks and flows for VAT/sales tax

2.1 VAT/sales tax collections by year (for last three years)
2.1.1 On imports
Answer:
2.1.2 On domestic transactions
Answer:

2.2 VAT/sales tax arrears by year-end (for last three years)
2.2.1 Composition of arrears (unpaid self assessed taxes, estimated taxes, penalties and interest, etc)?
Answer:

2.2.2 Months of tax (Stock of arrears/average tax collected per month)?
Answer:
2.2.3 Concentration by sector. Parastatal versus private sector?
Answer:

2.3 VAT credit carry forwards by year-end (for last three years)
2.3.1 Number of months (Stock of credits/average new credits generated per month)?
Answer:

2.4 Unpaid VAT/sales tax refunds by year-end (for last three years)
2.4.1 Number of months lag (Stock of refunds in arrears/average new refunds per month)?
Answer:
2.5 Taxes assessed based on enforcement actions
2.5.1 Self assessed and declared taxes
Answer:
2.5.2 Additional assessments based on audit of books and records
Answer:
2.5.3 Additional assessments based on estimated taxes without books and records
Answer:
2.5.4 Penalties
Answer:
2.5.5 Interest
Answer:

Tax policy questions
1. Identification of disadvantage caused to domestic suppliers caused by exemption of any particular product or service or exemption of purchases by any particular sector.
Answer:
2. Identification of disadvantages caused by restrictions or delays of refunds of any excess VAT input deductions whether from supply of exports or other zero rated items or through investment in physical capital or inventory.
Answer:
3. Identification of cross border shopping or trade caused by tax rate differentials.
Answer:
4. Identification of export fraud issues arising from zero rating exports.
Answer:
5. Self-perception of revenue potential of VAT (or conversion to VAT) as a replacement for trade tax revenues: What adjustments to rates and/or bases are contemplated to expand revenues?
Answer:

APPENDIX G
Meetings with Officials of SADC Member States

1. Angola

Note: The SADC National Contact Point and the Director Tax Registration and Collections Luanda hosted the meetings.

David Hollinrake met with:
1. Francisco Assis de Aurelio Junior, A/Director Tax
2. Ignacio (Julio) Domingos, Head of Section Collections Directorate Registration and Collections (and translator)
3. Jose Bast Balthazar, Head of Section Legal Directorate
4. Ana Maria Cesar, Head of Section (Registration) Directorate Registration and Collections
5. Ernest Bonito Almedi, Head of Section (Audit) Directorate of Audit
6. Miranda Sobrinho, Head of Section (Repartition) large Trader Control
7. Silvine Kiamva, Head of Section (Audit), Large Trader Control
8. Joan Jesus S Fernandes, Deputy Head of Section (Repartition) Large Trader Control

2. Botswana

Graham Glenday met with:
1. S. Lekau, Chief Customs Administrator (VAT), Department of Customs and Excise, Republic of Botswana
2. Gerry Cawley, Advisor, Ministry of Finance, Republic of Botswana

David Hollinrake met with:

Note: All posts were in the process of being transferred to the Botswana Unified Revenue Service

1. Bontle Ruth Lesedi, Director VAT, Department of Customs and Excise, Republic of Botswana
2. S. Lekau, Chief Customs Administrator, Department of Customs and Excise, Republic of Botswana
3. Mr Kaden Molapo Manager Audit (VAT), Department of Customs and Excise, Republic of Botswana
4. Tom Dikoloti, Manager Technical (legal interpretation and policy, VAT), Department of Customs and Excise, Republic of Botswana
5. My Prasaad, Information technology technician VAT, Department of Customs and Excise, Republic of Botswana

3. Democratic Republic of Congo (DRC)

No visits were made

4. Lesotho

David Hollinrake met with the following at Lesotho Revenue Authority:

1. Kevin Donovan, Commissioner General,
2. Jan Hansen, VAT Adviser
3. Nthako Sekome, Commissioner VAT
4. Moshe Neo Kao, Head Executive Support
5. Setsoto Ranthocha, Assistant Commissioner Direct Assessment
6. Retselisitsoe Motsoeneng, Assistant Commissioner Excise
7. Mosonngoa Monkhi, Assistant Commissioner Audit and Investigations
8. Motselisi Matsela, Senior Economist
9. Pule Chere, Assistant Commissioner VAT

5. Malawi

David Hollinrake met with the following officials in the Malawi Revenue Authority:

1. Crispin Kulimeka, Director, Policy, Planning and Research,
2. Ms Roza Fatchie, Deputy Director, Policy Planning & Research
3. Herbert Chirwa, Assistant Commissioner Surtax (Audit)
4. Humphry Mwalughali, Principal Revenue Officer, Enforcement and Collection
5. Kondwani Sauti–Phiri, Revenue Officer, Registration
6. Yasin Kalambang'ombe, Principal Revenue Officer, Audit
7. Billy Bwanali, Principal Training Officer, Training
8. Nellie Kolonda, Principal Revenue Officer, Refunds
9. Lucy Jones, Economist (DFID) Policy, Planning and Research

6. Mauritius

David Hollinrake met with:

1. Champawatee Gunnoo, Acting Commissioner VAT
2. Patrick Yip, Director Tax Policy Ministry of Finance
3. Beekhee, Senior Economist, Ministry of Finance
4. Asraff Dulull, Commissioner Large Taxpayer Department
5. Hurry, Assistant Commissioner Taxpayer Service
6. Boolack, Assistant Commissioner Repayment Audit
7. Udjdah, Senior Officer Intelligence Investigation and Control of Gaming Taxes;
8. Boodoo and Chiniah, Officers
9. Rogjee, Senior Officer Desk and Field Audit
10. Payen, Officer
11. Marie, Objections and Appeals
12. Gunjamaly, Assistant Commissioner Debt Management
13. Pierrot, Data Processing and IT

7. Mozambique

David Hollinrake met with:
1. Dr Aboobacar Z. D. Changa, Head of URTI (Inland Tax Reform Project) Director Ministry of Finance and Planning
2. Dr Sebastiao Banze, Chief of Division URTI (Director Ministry of Finance and Planning)
3. August Fernandes Junior, National Director Tax (Director Ministry of Finance and Planning)
4. Marie Filoueeces Councido Ribeiro, Director IVA - DNIA (Deputy Director Ministry of Finance and Planning)
5. Ilidio Guibalo, Deputy Director of Taxes and Auditing DNIA (Ministry of Finance and Planning)
6. Victorino Alfonso Clhuindya, Head of VAT Department, Returns Management and Control
7. Justino E Mutima, VAT I Department DNIA (URTI Project)
8. Helio Titos Macie, Department Chief Benefits DNIA who acted as translator

8. Namibia

David Hollinrake met with:
1. Anna Caroline Nakal, Commissioner: Revenue Management (HQ)
2. Jack le Roux, Deputy Director Legislation (HQ)
3. R B Strauss, Sub Division Legislation (HQ), Control Taxation
4. T. Mans, Operations (HQ)
5. S. Goliath, Deputy Director Taxation (HQ)
6. N. Mujentensa, Refunds (Windhoek Regional Office)
7. S. Groot Boon, Assessment Division (Windhoek Regional Office)
8. H.W. Stein, Audit Division (Windhoek Regional Office)
9. H. Jansen, New Registration (Windhoek Regional Office)

9. South Africa

Graham Glenday met with:
1. Martin Grote, Chief Director, Tax Policy Chief Directorate, National Treasury, South Africa and Chairperson of SADC Tax Subcommittee
2. Cecil Morden, Director, Indirect Tax, Tax Policy Chief Directorate, National Treasury, South Africa
3. Peter Frank, VAT Commissioner, South African Revenue Service
4. Muzi Khumalo, Director, Regional Integration, National Treasury, South Africa
5. David Hollinrake, Advisor to Tax Policy Chief Directorate, National Treasury, South Africa

David Hollinrake met with officials of the South African Revenue Service including:
1. Peter Frank, Law Administration

2. Donvan Hart, Law Administration
3. Prenesh Ramphal, Law Administration
4. Alan Toweell, Audit Manager

10. Swaziland

David Hollinrake met with:
1. Mjuta Vilakazi, Commissioner Customs
2. Alpheus Mdlulu, Deputy Commissioner Customs
3. Sibongile Mbhamali, Chief Customs Officer, Sales Tax
4. Malamwla O Dlamini, Principal Customs Officer, Excise
5. Richard Gamedze, Chief Customs Officer, Training
6. Estelle Shongwe, Principal Customs Officer, data input
7. John Msimango (now deceased), Principal Customs Officer, Audit and Post Audit
8. Peggy Mhlongo, Senior Customs Officer, Audit

11. Tanzania

David Hollinrake met with the following at Tanzania Revenue Authority:
1. J. N. Mally, AG Commissioner VAT
2. I. Nyange, Head of Technical Unit VAT
3. M. Mgaya, Debt Management Section (Dar HQ)
4. P.I. Marwa, Taxpayer Education Manager VAT (Dar HQ)
5. P.J. Kiatu, Technical Unit, VAT Section (DAR HQ)
6. B.M. Samson, Technical Unit, VAT Section (DAR HQ)
7. S. M. Mkindi, VAT Information Processing (VIPS)
8. R. Shao, Head of Operations (Sykes Regional office)
9. Y. Mzava, Ag Regional Revenue Officer (Sykes Regional office)
10. Hlupenja, Head of Compliance (Sykes Regional office)
11. Nkoto, Deputy Head Investigations/Prosecutions

12. Zambia

Graham Glenday met with:
1. Emmanul Ngulube, Director, Budget, Ministry of Finance and National Planning, Zambia
2. Danies Chisenda, Principal Economist, Tax Policy, Ministry of Finance and National Planning, Zambia
3. Harrison Banda, Commissioner VAT, Zambia Revenue Authority
4. Muyangwa Muyangwa, Deputy Commissioner, VAT Policy, Zambia Revenue Authority
5. Chriticles P. Mwansa, Commissioner Customs and Excise, Zambia Revenue Authority
6. Maarten de Zeeuw, RIZES Project Manager
7. Besa Muwele, Principal Statistician Central Statistical Office, Zambia

David hollinrake met with from the Zambia Revenue Authority:

1. Harrison Banda, Commissioner VAT (shortly to retire)
2. Muyangwa Muyangwa, Deputy Commissioner Operations (later promoted to Commissioner VAT)
3. Chris Habeenzu, Deputy Commissioner Policy
4. Tresphore Mulala, Assistant Commissioner VAT Policy
5. Derek Chonga, Assistant Commissioner Debt Management
6. Maimb Nyanga, Senior Economist (Statistics)
7. Moses Chuko, Assistant Commissioner Large Trader Control and VAT Investigations
8. Joy Muleya, Assistant Commissioner Audit
9. Namaka Ntini, Senior Inspector Advice Centre

And at the ministry of Finance and Planning:

1. Danies Chisenda, Principal Economist, Tax Policy, Ministry of Finance and Planning

13. Zimbabwe

David Hollinrake met with the following at the Zimbabwe Revenue Authority

1. E Mudzi, Commissioner, Projects and Planning, ZIMRA
2. C Chibaya, Legal Adviser to the Projects and Planning Division
3. Florence Jambwa, Secretary and Legal Adviser
4. Max Mugani, Legal Assistant
5. Godfrey Mutasa, VAT Supervisors (Audit)
6. Margaret Chakeredza, VAT Supervisors (Audit)
7. Christine Msemburi, Human Resources Manager
8. Tichaona Chiradza, Commissioner Investigations
9. Agatha Foroma, IT Manager
10. Andrew Matiza, Internal Audit
11. Shelton Pundo, Training Manager
12. Nixon Kanyemba, Public Relations Manager
13. Pricilla Sadomba, Public Relations Controller
14. Roseweeter Seremani, Public Relations